Washington, D.C., to enroll in its automobile mechanic training program. With help from the school, Armstrong obtained a $4,000 GSLP loan from the First Independent Trust Company of California ("FITCO"). One of the largest sources of loans for students attending for-profit schools in the late 1980s, FITCO was singled out for its abuse of the Guaranteed Student Loan Program during the hearings that led to the 1992 revamping of federal student loan policy. *See* Senate Report at 21-24, 28.

According to Armstrong, a National Business School representative prepared her loan application, specified the type of loan, determined the loan amount, prepared the promissory note, selected FITCO as the lender, presented the loan agreement to Armstrong to sign, and forwarded the loan application and promissory note to FITCO. *See* Am. Compl. ¶¶ 22, 24. Printed on standard forms provided by FITCO's guaranty agency, the promissory note contained a choice of law clause that subjected the loan contract to the laws of the state of the lender, in this case California. Like other student loan promissory notes issued at the time, the note contained no Holder Rule notice. Armstrong alleges that the school and its accrediting agency, the Accrediting Council for Continuing Education & Training, Inc. ("ACCET"), represented that the school offered a nationally accredited program in 1988; in fact, she claims, its accreditation had expired a year earlier. *See id.* ¶¶ 2, 29-34.

Armstrong claims that National Business School failed to provide the promised training, equipment, and job placement services, "leaving [her] and other students to repay student loans for an education that they never received." *Id.* ¶ 2; *see also id.* ¶ 77. The school closed its doors in 1990 and filed for bankruptcy. Although the school had charged each student over $5,000, Armstrong and other former students who filed

claims in the bankruptcy proceedings each recovered only $900. *See* Compl. ¶ 26.

Armstrong filed suit in the United States District Court for the District of Columbia, asserting federal claims based on the FTC Holder Rule and the Department's school-origination policy, as well as pendant state law claims based on the District of Columbia Consumer Credit Protection Act ("CCPA") and common law contract doctrines. The complaint sought damages, restitution, and declaratory relief against ACCET and each of the entities that could enforce the loan, all appellees in this case: Bank of America, N.T. & S.A. (the current loan holder); California Student Loan Financing Corporation (a corporation that acquires student loans on the secondary market and which directed Bank of America to purchase Armstrong's loan as its trustee); the Secretary of Education (who assumed the guarantee of Armstrong's loan after the original guarantor became insolvent); and Educational Credit Management Corporation (a corporation created by the Department to manage loan guarantees assumed by the Secretary). Dismissing her federal claims, the district court held that no cause of action arises under the Department's school-origination policy or the FTC Rule. *See Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc.*, 832 F. Supp. 419, 432 (D.D.C. 1993) ("*Armstrong I*"). Armstrong now concedes this point. The district court also dismissed Armstrong's state law claims except her common law fraud and misrepresentation claims against ACCET. *See id.* at 425-26, 434.

On appeal, this court found that the district court, having dismissed the federal claims, failed to "expressly exercise its discretion to maintain or decline jurisdiction over the pendant claims under 28 U.S.C. § 1367." *Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc.*, 84 F.3d 1452

(D.C. Cir. 1996) (unpublished table decision), 1996 WL 250412, at *1. We remanded to the district court for further proceedings.Exercising its discretion, the district court again dismissed Armstrong's claims as to all defendants except ACCET (which subsequently settled with Armstrong and is no longer involved in these proceedings). *See Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc.*, 980 F. Supp. 53 (D.D.C. 1997) ("*Armstrong II*"). The district court held that Armstrong had no claim under the District of Columbia CCPA because the choice of law clause made California law applicable. It rejected her argument that the so-called "public policy exception" in choice of law doctrine required D.C. courts to override the choice of law clause and to apply the District's more protective consumer protection statute instead. *See id.* at 59-60. As to Armstrong's mistake and illegality claims, the district court found that the school had not lost its GSLP eligibility until after she enrolled, and that at any rate federal Higher Education Act policy preempted state law defenses based on lack of school accreditation. *See id.* at 61-64.

Appealing again, Armstrong reasserts her state law claims, arguing: (1) that the Holder Rule notice should be implied into her loan contract; (2) that the school's loss of accreditation rendered it ineligible to participate in the GSLP program, making her loan unenforceable on grounds of mistake or illegality; and (3) that the district court should not have applied the choice of law clause because it conflicts with D.C. public policy enacted to protect District citizens. With respect to the last claim, Armstrong asks us alternatively to certify the choice of law question to the District of Columbia Court of Appeals. Our review is *de novo*. *See Systems Council EM-3 v. AT&T Corp.*, 159 F.3d 1376, 1378 (D.C. Cir. 1998).

II

We begin with Armstrong's implied contract claim. Relying on the FTC Holder Rule, she argues that National Business School had a "referral relationship" or "affiliation" with FITCO, thus permitting her to treat subsequent lenders as "standing in the shoes" of the school and to assert the school's misconduct as a defense against loan repayment. As the government acknowledged at oral argument, had Armstrong signed her loan contract after the 1992 amendments to the Higher Education Act, at which point the Secretary incorporated the Holder Rule notice into the common promissory note, she might well have a claim. Armstrong's allegation that the school gave her a loan application preprinted with FITCO's name as the chosen lender would support a Holder Rule notice claim because the school "*recommend[ed]* that the applicants seek loans" from FITCO, and FITCO either supplied the preprinted forms itself or "kn[e]w that a loan applicant was referred by [the] school." Overview, FTC Rule at 2, 3.

Acknowledging that her pre-1992 loan agreement contained no Holder Rule notice, Armstrong argues that the FTC's Holder Rule nevertheless required the notice's inclusion and that the court should therefore enforce it as an implied contractual term. She relies on the common law principle that contracts incorporate the law in force at the time of the agreement. *See United Van Lines, Inc. v. United States*, 448 F.2d 1190, 1195 (D.C. Cir. 1971) ("Because the regulation was in existence at the time [the party] entered on performance, it became, in effect, a part of the contract between the parties."); *see also Ballarini v. Schlage Lock Co.*, 226 P.2d 771, 773-74 (Cal. 1950) ("The settled law of the land at the time a contract is made becomes a part of it and must be read into it."). Appellees disagree. They argue that the FTC Holder Rule did

not apply to student loans made in 1988 and that even if it did, its terms cannot be implied into Armstrong's agreement.

We think appellees have the better of this argument. Although the Truth in Lending Act, the source of the Holder Rule, originally covered GSLP lending, Congress expressly exempted student loans from the Act in 1982. At that point the FTC stopped enforcing the Holder Rule with respect to GSLP loans. Not until after Armstrong obtained her loan from FITCO did the FTC again begin enforcing the Holder Rule in GSLP loans, and not until after that did the Secretary incorporate the notice into the common promissory note. *See supra* at 4, 5. Facing circumstances very much like those presented in this case, the Seventh Circuit, relying on the 1982 TILA Amendments, expressly held the Holder Rule inapplicable to guaranteed student loans obtained prior to renewal of Holder Rule enforcement. *See Veal v. First Am. Sav. Bank*, 914 F.2d 909, 914 (7th Cir. 1990).

To be sure, both the FTC and the Secretary have since suggested that the Holder Rule did in fact apply to guaranteed student loans during the period when Armstrong obtained her loan. *See* FTC Opinion at 2-3 (rejecting its previous "literal interpretation" exempting GSLP loans from the Holder Rule and claiming that Congress did not mean to exclude such loans from the Rule's coverage when it exempted them from TILA); Overview, FTC Rule at 1 (concluding that "the FTC Holder Rule notice must be included in the common application/promissory note."). In our view, however, these later developments are insufficient to overcome the clear implications of the 1982 TILA Amendments and the FTC's nonenforcement policy. Moreover, even if there were some ambiguity as to the Holder Rule's applicability to student loans during the late 1980s, we would not imply the terms of the notice into Armstrong's loan for one simple reason: No one

could reasonably argue that in 1988 appellees, the purchasers and assignees of Armstrong's note (which contained no Holder Rule notice), should have known that the Holder Rule nevertheless applied to GSLP loans at that time. Lenders still operated under a federal program that encouraged them to make loans for attendance at virtually any accredited school, no matter how deficient or disreputable. While Congress and the Department have since changed the rules, we think it would be unfair to apply the new rules to old loans.

Relying on contract-based theories of mistake and illegality, Armstrong next claims that her loan is void and unenforceable because National Business School had lost its accreditation in 1987 and was therefore not an institution "eligible" for participation in the federal student loan program. *See* 20 U.S.C. § 1085(a), (c) (1988). The district court rejected this claim, holding that schools do not lose their GSLP eligibility until after a hearing before an administrative law judge; in this case the hearing did not occur until 1989, a year after Armstrong received her loan. Armstrong now argues that the district court mistakenly relied on regulatory instead of statutory eligibility rules. She points out that under statutory rules, "the effective date of a loss of eligibility by reason of the failure of an institution, its location, or its program to satisfy the applicable definitions continues to be the date on which the failure first occurred." 55 Fed. Reg. 32,181 (1990) (Secretary's explanation of the effects of failure to meet statutory requirements). We need not resolve this dispute to decide this case, for regardless of when National Business School lost its GSLP eligibility, we agree with the Secretary that federal student loan policy preempts Armstrong's claims.

Federal preemption can be express or implied. *See Cippollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992). Nothing in the Higher Education Act expressly preempts state

law claims of the kind raised by Armstrong. Implied preemption occurs either "where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress 'left no room' for supplementary state regulation" (known as field preemption) or "in those areas where Congress has not completely displaced state regulation, ... to the extent [state law] actually conflicts with federal law" (known as conflict preemption). *California Fed. Sav. & Loan Ass'n v. Guerra*, 479 U.S. 272, 281 (1987) (internal quotation omitted). In *Jackson v. Culinary School*, we held that federal education policy regarding GSLP lending is not so extensive as to occupy the field. *See Jackson v. Culinary Sch.*, 27 F.3d 573, 580-81 (D.C. Cir. 1994), *vacated on other grounds*, 515 U.S. 1139, *on reconsideration*, 59 F.3d 354 (D.C. Cir. 1995). *Jackson* also recognized that the Higher Education Act preempts D.C. laws that "actually conflict" with federal law. *Id.* at 581 (stating but declining to reach the conflict preemption issue). Although *Jackson* was later vacated on other grounds, we believe that it correctly stated and applied federal preemption standards.

"Actual conflict" between Armstrong's contract claims and Higher Education Act regulations is precisely what has occurred here. If accepted, Armstrong's claim that she may void her student loan based on the school's alleged GSLP ineligibility would frustrate specific federal policies regarding the consequences of losing or falsely certifying accreditation. For example, it is the Secretary and guaranty agencies—not students—who enforce statutory and regulatory requirements, including those concerning accreditation and school misrepresentation. *See* 20 U.S.C. § 1094(c) (1988); 34 C.F.R. §§ 668.71-.75, 682.700-.710 (1988). Reinforcing this point, the preamble to the final rule regarding institutional eligibility says this:

> [The Department] considers the loss of institutional eligibility to affect directly only the liability of the institutionfor Federal subsidies and reinsurance paid on those loans.... [T]he borrower retains all the rights with respect to loan repayment that are contained in the terms of the loan agreements, and [the Department] does not suggest that these loans, whether held by the institution or the lender, are legally unenforceable merely because they were made after the effective date of the loss of institutional eligibility.

58 Fed. Reg. 13,337 (1993). Moreover, the Department expressly permits lenders to rely in good faith on eligibility representations by students and schools so long as the schools did not "originate" the loans. *See* 34 C.F.R. § 682.206(a)(2) (1988). Allowing mistake and illegality claims based on GSLP eligibility requirements to void student loan repayment obligations would "stand[ ] 'as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *Guerra*, 479 U.S. at 281 (*quoting Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

This brings us finally to Armstrong's claim under the District of Columbia Consumer Credit Protection Act. She relies on section 28-3809, which provides:

> (a) A lender who makes a direct installment loan for thepurpose of enabling a consumer to purchase goods or services is subject to all claims and defenses of the consumer against the seller arising out of the purchase of the goods or service if such lender acts at the express request of the seller, and—
>
> > (1) the seller participates in the preparation of the loan instruments....

D.C. Code Ann. § 28-3809 (1981). Characterizing her guaranteed student loan as a "direct installment loan," Armstrong argues that National Business School's marketing of FITCO loans through preprinted application forms, along with its assistance in filling out loan applications, brings her loan within the CCPA's protection. According to appellees, the district court properly dismissed Armstrong's CCPA claim on the ground that the promissory note's choice of law clause made California law applicable. *See Armstrong II*, 980 F. Supp. at 58-60.

We need not determine whether D.C. courts would set aside the choice of law clause as contrary to D.C. public policy or whether, alternatively, to certify this question to the D.C. Court of Appeals, because we again agree with the Secretary that Armstrong's state law cause of action conflicts with pre-1992 federal policy governing guaranteed student loans. As we have noted, pre-1992 federal student loan policy was intended to make student loans attractive to private lenders by protecting them from the financial consequences of student default. Although the Department's school-origination policy certainly allows students to raise school misconduct defenses in limited circumstances, the Department expressly warned that the policy was "not intended to create any other rights for student borrowers or to suggest that borrowers are excused from repaying loans" except where there is a school-origination relationship. 58 Fed. Reg. 13,337 (1993). Allowing student borrowers to raise CCPA defenses based on school misconduct against lenders who do no more than permit schools to "participate[ ] in the preparation of the loan instruments" at the schools' "request," D.C. Code Ann. § 28-3809(a), would extend lender liability beyond school- origination relationships. In letter rulings discussing circumstances closely mirroring the facts of this case, the Secretary assured lenders that they do *not* risk falling within the scope of the school-origination policy

merely by "market[ing] GSL lending by sending combined application/promissory note/disclosure forms ... with the lender's name preprinted thereon, directly to the school," and allowing schools to assist students in completing loan applications on those forms. Letter from John E. Dean, Clohan & Dean, to Larry Oxendine, Director, Division of Policy and Program Development, U.S. Dep't of Educ. (Dec. 14, 1990); Letter from Larry Oxendine to John E. Dean (Feb. 20, 1991). Permitting Armstrong to raise CCPA defenses against repayment of her pre-1992, pre-common promissory note loan would subject appellees to risks neither anticipated by them nor intended by the Guaranteed Student Loan Program.

Nothing in *United States v. Griffin*, 707 F.2d 1477 (D.C. Cir. 1983), requires a different result. There, we found no preemption of state law defenses by a different student loan program under which the federal government insures GSLP loans made directly by schools. Because under that program the student borrowed directly from the school, the Department's school-origination policy squarely applied, and the asserted state law claims did not expand lender risk beyond that contemplated by federal policy. Moreover, allowing students to raise school misconduct defenses against the federal government could have had no impact on the private lending that Congress considered so critical to the operation of the pre-1992 Guaranteed Student Loan Program.

III

We acknowledge that denying relief to Armstrong may seem unfair. Lenders that permitted schools to abuse the Guaranteed Student Loan Program and that profited enormously prior to the 1992 changes are protected by federal preemption. Owners of schools that profited from student loans while failing to provide promised training and resources

are protected by bankruptcy laws. Only the students, the very people the Guaranteed Student Loan Program was intended to benefit, are left holding the bag.

The 1992 changes in the federal student loan program went a long way toward eliminating this unfairness for students who borrowed after 1992. The Secretary has even established loan discharge procedures for two categories of pre-1992 borrowers: those whose for-profit schools closed while they were in attendance, and those whose own GSLP eligibility (not the school's eligibility) was falsely certified. *See* 34 C.F.R. § 682.402(d), (e) (1997). These procedures provide no relief for students like Armstrong, whose schools falsely represented their accreditation or engaged in other misconduct. We have no authority to protect such students, but we think the Secretary does. *See* 20 U.S.C.A. §§ 1082(a), 1087-0 (Supp. 1998).

So ordered.

KAREN LECRAFT HENDERSON, *Circuit Judge*, concurring:

I concur in the result but neither agree with nor deem appropriate the concluding two paragraphs of the opinion. The student loan program may have its flaws but there is no basis to wring our hands over this one, especially when defaulting student loan borrowers constitute a significant national problem in the administration of the program.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued October 2, 1998 Decided March 23, 1999

No. 97-5316

Vanessa Armstrong,
Appellant

v.

Accrediting Council for Continuing Education and
Training, Inc., et al.,
Appellees

On Petition for Rehearing

Before: Henderson, Randolph and Tatel, *Circuit Judges.*

ORDER

On consideration of appellant's petition for rehearing, it is

Ordered by the court that the petition be denied and that the slip opinion filed herein on March 23, 1999 (reported at 168 F.3d 1362) be amended as follows:

On page 4 of the slip opinion (168 F.3d 1364-65), delete the first two sentences of the paragraph beginning "To further encourage ..." and replace them with the following:

Congress also excluded GSLP loans from the Truth in

> Lending Act ("TILA"), see Pub. L. No. 97-320, sec. 701(a), § 1603, 96 Stat. 1469, 1538 (1982), and the FTC stopped enforcing its so-called "Holder Rule" against GSLP lenders. See Federal Appellee's Br. at 25 ("1982 TILA amendments exempting student loans from TILA coverage convinced both courts and FTC staff that the Holder Rule thereafter no longer applied to GSLP loans."). Adopted by the FTC in 1976,....

On page 6 (168 F.3d 1365), in the first full sentence, replace the phrase stating "together with the FTC's renewed enforcement policy" with "together with the FTC's decision to enforce the Rule with respect to guaranteed student loans."

On page 10 (168 F.3d 1368), delete the two sentences following the sentence stating "We think appellees have the better of this argument" and replace them with the following:

> In 1982, Congress expressly exempted student loans from the Truth in Lending Act. At that point, because the Holder Rule incorporated TILA's definitions and was therefore considered limited to credit transactions covered by TILA, see 16 C.F.R. s 433.1(d), (e), the FTC stopped enforcing the Holder Rule with respect to GSLP loans. In a letter dated April 12, 1990, FTC staff, reiterating advice given in an earlier letter, described its "current enforcement position" as "[GSLP] loans would not be covered by the Holder Rule." Letter from John F. LeFevre, Program Advisor, Federal Trade Commission, to Joseph Esposito, Akin, Gump, Strauss, Hauer & Feld (Apr. 12, 1990). Although this advice was later "retracted," see Letter from John F. LeFevre to Joseph Esposito (June 20, 1990), that retraction related to future enforcement, and nothing in either it or elsewhere in the record contradicts the government's statement that the FTC stopped enforcing

the Holder Rule against GSLP lenders after the 1982 TILA Amendments. Not until after Armstrong obtained her loan....

On page 11 (168 F.3d 1368), replace the words "nonenforcement policy" in the second sentence of the full paragraph with "nonenforcement of the Holder Rule."

On page 14 (168 F.3d 1370), amend the last sentence on the page beginning "In letter rulings ..." to read: "In letter rulings discussing circumstances closely mirroring the facts of this case, *see Maljack Prods., Inc. v. Motion Picture Ass'n of America, Inc.*, 52 F.3d 373, 375 (D.C. Cir. 1995) (on motion to dismiss we accept the facts alleged in the complaint as true), the Secretary...." In addition, after the citation to "Letter from Larry Oxendine to John E. Dean (Feb. 20, 1991)" on page 15, add the following: "; see also 57 Fed. Reg. 60,304 ("The Secretary has also decided to describe an 'origination relationship' as a special business relationship between a school and a lender so as to distinguish it from the relationship that exists between these parties as part of the normal loan processing and delivery system.")."

Per Curiam

For the Court:
Mark J. Langer, Clerk
By: Deputy Clerk

Filed, September 30, 1997
[980 F. Supp. 53]

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No.: 91-3135 (RCL)

VANESSA ARMSTRONG,

Plaintiff,

v.

ACCREDITING COUNCIL FOR
CONTINUING EDUCATION &
TRAINING, INC., *et al.*,

Defendants.

MEMORANDUM OPINION

This matter comes before the court on remand from the Court of Appeals, *Armstrong v. Accrediting Council for Continuing Education and Training, Inc.*, 318 U.S. App. D.C. 78, 84 F.3d 1452 (D.C. Cir. 1996) (unpublished table decision), and on defendants' renewed motions to dismiss plaintiff's remaining claims pursuant to Fed. R. Civ. P. 12(b)(2) and (6). In the alternative, defendants seek summary judgment on these claims. For the reasons stated below, defendants Bank of America, California Student Loan Finance Corporation, Higher Education Assistance Foundation and the Secretary of Education's motions to dismiss are granted in full in accordance with this opinion.

I. BACKGROUND

A. Factual Background

As this motion comes before the court under Fed. R. Civ. P. 12(b)(2) and (6), defendants must prove that there is no set of facts upon which plaintiff is entitled to relief as a matter of law. *Conley v. Gibson*, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957) All allegations set forth in the complaint must be accepted as true and liberally construed in favor of plaintiff and all reasonable inferences must be drawn in favor of plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232, 236, 40 L. Ed. 2d 90, 94 S. Ct. 1683 (1974). The complaint should be dismissed only if it appears beyond doubt that there is no set of facts proffered in support of plaintiff's claim that would entitle her to relief. *Conley*, 355 U.S. at 45-46; *Haynesworth v. Miller*, 261 U.S. App. D.C. 66, 820 F.2d 1245, 1254 (D.C. Cir. 1987).

Plaintiff Vanessa Armstrong enrolled in the Washington, D.C. campus of NBS Automotive School ("NBS"), a for-profit vocational school, in June 1988. At the time of her enrollment, NBS informed plaintiff that tuition for the program would exceed $ 5,000 but that the school could arrange a guaranteed student loan ("GSL") to pay most of the charges. According to plaintiff's amended complaint, NBS represented to her that its program was accredited by the Accrediting Council for Continuing Education and Training ("ACCET"), approved by the D.C. Educational Licensure Commission and certified by the Department of Education ("DOE" or "Department") as an "eligible institution" under the GSL program and the Higher Education Act of 1965, 20 U.S.C. §§ 1070 et seq. ("HEA"). Plaintiff Armstrong paid $ 1,317.91 directly to NBS, and NBS presented her with a loan application and promissory note for a GSL loan of $ 4,000, representing the balance of the tuition and fees.

According to the amended complaint, NBS "prepared the loan application and promissory note presented to plaintiff Armstrong, selected the lender and guarantee agency, specified the type of loan, determined the loan amount, made disclosures concerning the terms of the GSL loan, had plaintiff sign the promissory note, and disbursed the loan proceeds." Plaintiff's Amended Complaint at 8. The note provided that the loan was to be issued by First Independent Trust Company of California ("FITCO"), with the Higher Education Assistance Foundation ("HEAF") acting as guarantor. Plaintiff signed the application and the note on July 19, 1988. NBS certified that plaintiff met eligibility requirements for the loan, at which time FITCO and HEAF approved the loan and paid the proceeds to NBS.

Bank of America ("BA"), an eligible lender under 20 U.S.C. § 1085(d), subsequently purchased the plaintiff's GSL as trustee for the California Student Loan Finance Corporation ("CSLFC"), a corporation which acquires student loans under the HEA. BA is the current "holder" of the note. *See* 20 U.S.C. § 1085(i). FITCO, the original lender, was not named as a defendant in this action.

In or about December 1989, NBS closed its school in the District of Columbia. At the time of the filing of her amended complaint, plaintiff had made payments on her GSL loan of over $1,500. Over the ten year repayment period of the loan, the total of the monthly payments and interest is $7,565.76.

The gravamen of plaintiff's complaint is that she was defrauded by NBS, that the school was "a sham because it did not meet the standards for accreditation and failed to provide the educational training it promised," Plaintiff's Amended Complaint at 1-2, and that she should not be required to repay her creditors for an education she never received. She claims

that NBS was falsely accredited, and that she reasonably relied on NBS's representations concerning its program in deciding to enroll. Plaintiff initially filed a four-claim complaint, naming as defendants CSLFC, BA, HEAF, the Secretary of Education ("the Secretary") (as ultimate guarantor of all GSLs) and ACCET, the agency that granted accreditation to NBS, allowing the school to qualify for federal funds under the HEA. Plaintiff filed her amended complaint in October 1993 pursuant to this court's order in *Armstrong v. Accrediting Council for Continuing Education & Training, Inc.*, 832 F. Supp. 419, 435 (D.D.C. 1993) ("*Armstrong I*"), revising her claims against the Secretary and ACCET. Significantly, NBS has never been a party to this action.

B. Procedural History

In *Armstrong I*, this court held first that plaintiff could not assert a cause of action against defendants CSLFC/BA[1], HEAF, or the Secretary on common-law contract grounds of mistake or illegality.[2] *Armstrong I*, 832 F. Supp. at 426-27. Second, the

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[1] Because the relationship between Bank of America and the California Student Loan Finance Corporation make their interests identical and all motions have been filed jointly, they will hereinafter be referred to singularly as BA/CSLFC.

[2] *Armstrong I* also addressed claims against ACCET based on portions of the District of Columbia Consumer Protection Procedures Act, D.C. Code § 28-3904 (unfair trade practices) and common-law misrepresentation, with the former claim being dismissed. *Armstrong I*, 832 F. Supp. at 423-26. Cross-motions for summary judgment on the common-law misrepresentation claim were denied in *Armstrong v.*

court dismissed claims asserted under various sections of the D.C. Code, including §§ 28-3807, 3809 and 3813(f), concluding that although the HEA does not explicitly or implicitly preempt all state law, the particular statutory claims asserted by plaintiff were preempted because it was either impossible for an individual to abide by both the state law and the HEA, or enforcement of the D.C. statutory claims would preclude execution of the purposes and objectives of the HEA. *See id.* at 427-31. Third, the court dismissed both federal law and D.C. statutory/regulatory claims purportedly arising under the FTC Holder Rule, 16 C.F.R. § 433.2. *See id.* at 431-33. Finally, this court dismissed plaintiff's claims based on the existence of an "origination relationship" under 34 C.F.R. § 682.200 between the school and the initial lender against all defendants except the Secretary. *See id.* at 433-34.

On appeal, the D.C. Circuit vacated the above ruling and remanded the matter for further consideration. *Armstrong v. Accrediting Council for Continuing Education & Training, Inc.*, 318 U.S. App. D.C. 78, 84 F.3d 1452 (D.C. Cir. 1996) ("*Armstrong II*") (unpublished table decision). The Court of Appeals directed this court to consider first whether, in the absence of any remaining federal law claims, jurisdiction should be maintained under 28 U.S.C. § 1367(C)(3). After reviewing the written submissions and oral arguments of all parties, the court decided to exercise jurisdiction and reach the merits of plaintiff's case, and further determined that declaratory relief was appropriate as to the pendent state claims. *Armstrong v.*

Accrediting Council for Continuing Education & Training, Inc., 961 F. Supp. 305 (D.D.C. 1997) ("*Armstrong IV*"), and therefore need not be revisited in this opinion.

Accrediting Council for Continuing Education & Training, Inc., 950 F. Supp. 1 (D.D.C. 1996) ("*Armstrong III*").

Having decided to exercise its jurisdiction, this court must now consider the remaining questions presented to it by the Court of Appeals. Specifically, this court is called upon to: 1. determine applicable state law under contemporary choice of law principles; 2. consider whether that law is preempted by the federal Higher Education Act; and, 3. if the state law is not preempted, review the application of the relevant law to plaintiff's claims.

Second, the Secretary has now moved to dismiss the claims against him based upon an alleged "origination relationship" between NBS and FITCO. This court will address that question pursuant to the Secretary's and HEAF's Renewed Motion to Dismiss.

Finally, in plaintiff's amended complaint, her second claim for relief alleges a cause of action against the Secretary under 20 U.S.C. §§ 1087(c)(1),(5) which directs the Secretary to discharge a borrower's liability by repaying the amount owed on the loan on all GSLs received on or after January 1, 1986 and report such discharge to credit bureaus if the student's eligibility under the HEA was falsely certified by the institution or if the student was unable to complete the program due to closure of the institution. Plaintiff alleges that she has been injured by the failure of the Secretary to perform these statutory obligations, and asks for relief in the form of a declaratory judgment and a writ of mandamus compelling the Secretary to perform his duties.

II. CHOICE OF LAW

In her complaint, plaintiff asserted a number of causes of action under District of Columbia law, including, *inter alia*, D.C. Code §§ 28-3809(a)(1), 28-3904(a),(b),(e),(f),(r); 28-3807; and 16 D.C. Mun. Regs. § 1212.1. However, the Supplemental Loan for Students (SLS) Application/Promissory Note signed by plaintiff included the following provision:

> To the extent not governed by federal law, this note shall be governed by the laws of the jurisdiction where the lender is located.

The original lender, FITCO, was located in Sacramento, California; BA/CSLFC are also California based. If the contractual choice of law provision is held operative and binding, California law would govern this case, thereby rendering all of plaintiff's District of Columbia claims invalid, with the exception of her claims based upon common-law principles of mistake and illegality, which, as discussed below, have previously been considered and dismissed by this court. *See Armstrong I*, 832 F. Supp. at 426-27. Whether a choice of law clause in a student loan contract is enforceable is a matter of first impression in this jurisdiction.

A federal court is directed to apply the choice of law rules for the forum in which it sits. *See A.I. Trade Finance, Inc. v. Petra International Banking Corp.*, 314 U.S. App. D.C. 122, 62 F.3d 1454, 1463-64 (D.C. Cir. 1995) ("In other settings in which a federal court must rule upon an issue regulated only by state law, it applies the forum state's choice of law rules . . . ."). *See also Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487, 496, 85 L. Ed. 1477, 61 S. Ct. 1020 (1941) ("It is not for the federal courts to thwart such local policies by enforcing

an independent "general law" of conflict of laws."). Consequently, this court will apply choice of law doctrine from the District of Columbia.

Before addressing the applicability of the choice of law clause in the loan contract, there exists a threshold question as to which jurisdiction's law would apply absent the clause. To determine controlling law, the District of Columbia follows an "interest analysis" approach. The law governing the case is the law of the jurisdiction with the most "significant relationship" to the matter at issue. *Trout Unlimited v. United States Dep't of Agriculture*, 944 F. Supp. 13, 19 (D.D.C. 1996) (*citing Church of Scientology Int'l v. Eli Lilly & Co.*, 848 F. Supp. 1018, 1026 (D.D.C. 1994)); *see also Greycoat Hanover F. Street Limited Partnership v. Liberty Mutual Insurance Co.*, 657 A.2d 764, 767-68 (D.C. App. 1995) (noting that the fact that an incident occurred in D.C. is not independently sufficient to require the application of D.C. law). Plaintiff Armstrong is a Maryland resident and NBS is a Maryland corporation. The initial lender, FITCO, was a California corporation that made the loan from California. Plaintiff's loan payments were mailed to CSLFC in California; BA, the current holder of the note, is also located in California. Finally, the NBS branch plaintiff attended was located in the District of Columbia, and the loan that is the subject of this action was negotiated and signed by plaintiff at NBS' facilities in the District of Columbia. Consequently, any of one of three jurisdictions has a substantial nexus to this transaction, and an argument could be made under D.C.'s prevailing "interest analysis" choice of law doctrine that its law should apply.

As among these three options, this court holds that District of Columbia law would govern this action absent the choice of law clause from the loan contract. First, there is authority for the

proposition that when a consumer purchases goods and services in the District, the law of the District governs the contract. *McCrossin v. Hicks Chevrolet, Inc.*, 248 A.2d 917, 920-21 (D.C. App. 1969). Here, the purchase of the services -- the signing of the loan agreement -- occurred in D.C. In addition to being the place of contracting, D.C. was also the place of performance and the location of the subject matter of the contract, NBS. These factors tip the balance in favor of recognizing D.C. law as the relevant law but for the choice of law clause.

District of Columbia choice of law doctrine recognizes the ability of parties to select the operative law they wish to govern a transaction as part of their freedom of contract, provided that the jurisdiction selected has a "substantial relationship" to the parties or the transaction. *Norris v. Norris*, 419 A.2d 982, 984 (D.C. App. 1980). A recent enunciation of this "substantial relation" test, recognizing the validity of a choice of law clause, is found in *Ekstrom v. Value Health Inc.*, 314 U.S. App. D.C. 340, 68 F.3d 1391, 1394 (D.C. Cir. 1995), in which the court cited Norris and upheld the selection of Connecticut law on contracts and arbitrability because the surviving entity in a merger operated principally in Connecticut. *See also Gray v. American Express Co.*, 240 U.S. App. D.C. 10, 743 F.2d 10, 17 (D.C. Cir. 1984) (applying Maryland choice of law principles in upholding the contractual selection of New York law because one of the parties was a New York corporation and the choice bore some substantial relation to the parties or their transaction); *cf. Milanovich v. Costa Crociere*, 293 U.S. App. D.C. 332, 954 F.2d 763, 767 (D.C. Cir. 1992) (noting that under American law, choice of law provisions are usually honored); Restatement (Second) of Conflict of Laws § 187 (1971).

There is little question that California has a substantial

relation to the loan transaction at issue. FITCO, the initial lender, was a California based corporation (as are BA and CSLFC) located in Sacramento. The location of one of the two parties to the loan contract in California creates the critical nexus between the transaction and the jurisdiction indicated in the choice of law clause such that this court is compelled to apply that forum's law. *See Gray*, 743 F.2d at 17 (holding that because American Express was a New York corporation, there was a sufficient basis to defer to the clause calling for the application of New York law). Also contributing to California's "substantial relation" is the fact that the loan was approved by FITCO in California, and the plaintiff made her payments to CSLFC in California.

Plaintiff's opposition to the validity of the choice of law clause does not take issue with this application of the "substantial relation" test. Rather, she seeks to avoid the effects of the choice of law provision by claiming that the purpose of the clause was to frustrate the protections afforded by D.C.'s consumer protection laws. *See* Plaintiff's Opening Memorandum on Resolution of the Merits on Remand at 17 ("Plaintiff's Opening Memorandum"). It is a general principle of choice of law doctrine that if a party or parties stipulate to a given forum's law, that stipulation will not be given effect if it is included for the express purpose of evading otherwise applicable law or is contrary to either public policy or a statute enacted for the protection of that state's citizens. *See, e.g., Allen v. Lloyd's of London*, 94 F.3d 923, 928 (4th Cir. 1996) (outlining situations under which choice of law and choice of forum provisions may be found unreasonable); 16 Am. Jur. 2d Conflict of Laws § 78 (1979).

However, the GSL loan contract under consideration here does not present the type of situation in which courts typically

invalidate choice of law provisions. FITCO did not deliberately or willfully select California law with the nefarious purpose of avoiding the effect of District of Columbia consumer protection laws. Nor did FITCO endeavor to select a state with particularly relaxed consumer protection laws. The forum selection clause in question is boilerplate language which calls for the application of "the laws of the jurisdiction where the lender is located." It does not specify the selection of any one particular state. Under this clause, had the lender been a District of Columbia bank, the loan contract would have called for the application of District of Columbia law. Had the lender been a Texas bank, the choice of law clause would have directed this court to apply Texas law. In the instant case, because the lender was a California bank, the choice of law clause mandates the application of California law. It may very well be the case that California has a more generous body of consumer protection law than does the District of Columbia. The purpose of this clause had nothing to do with avoiding the District's laws or its public policies. It is both rational and reasonable for a lender to operate consistently under laws of its home state, rather than be forced to operate under 51 different laws depending upon the location of the "object of the loan contract," which is the result that plaintiff's argument would compel.

Furthermore, this is not a case, as plaintiff characterizes it, where a lender seeks to "evade these statutes by making his own laws applicable." Plaintiff's Opening Memorandum at 17 (*citing* A. Ehrenzweig, A Treatise on Conflict of Laws § 204, at 523 (1962)). The choice of law clause was not inserted by FITCO. FITCO was utilizing HEAF's standard form promissory note, as it was required to do by law. The note in question, with its boilerplate choice of law clause, was approved by DOE for use throughout the United States. *See* 34 C.F.R. § 682.401(d)(1)(1990) ("The guaranty agency shall submit to the

Secretary its application forms, promissory notes and write-off criteria and procedures. The agency shall not use these materials until the Secretary approves them."). This is hardly the paradigmatic situation in which lenders are trying to "frustrate statutes designed to regulate their conduct." Plaintiff's Opening Memorandum at 18. Rather, FITCO was using the loan form that federal law directed it to use, and was therefore compelled to accept both the benefits and the burdens of the law of the jurisdiction in which it was located -- California. Plaintiff must similarly accept the benefits and burdens of California law.

This conclusion, though never expressly reached in this jurisdiction, was hinted at by the D.C. Circuit in *Jackson v. Culinary School of Washington, Ltd.*, 307 U.S. App. D.C. 123, 27 F.3d 573 (D.C. Cir. 1994) ("*Jackson II*"). In addressing the question as to whether students could utilize the District of Columbia's consumer protection laws to assert defenses against their lenders, the Court of Appeals, in declining to resolve HEA preemption issues, wrote, "we find ourselves unable to say with confidence that D.C. law will apply in any future coercive action brought by the declaratory judgment defendants." 27 F.3d at 581. In a footnote, the court continued, "To the extent the record points any direction on choice of law, it points against appellants, because several of the loan instruments in the case contain express choice of law provisions identifying other states' laws as providing the operative rules of decision." *Id.* at 581 n.14.

Because California has a substantial relation to the transaction, and because the choice of law clause was not inserted with the express purpose of evading otherwise applicable local consumer protection laws, this court will give effect to the choice of law clause in the loan contract. Consequently, to the extent that state law governs this case,

California law applies. This court is therefore compelled to dismiss all of plaintiff's claims arising under the both the D.C. Code and D.C. municipal regulations. This conclusion does not, however, leave plaintiff without any state or local law causes of action: she is, of course, entitled to whatever protections may be available under California law, and may seek leave to refile yet another amended [3]

III. PREEMPTION

The Court of Appeals next directs this court to determine whether the applicable state law is preempted by the Higher Education Act. Because the plaintiff has not asserted any statutory claims under California law, a full exegesis on this question is not possible, as one cannot determine whether compliance with state law is either "impossible" or "precludes execution of the purposes and objectives of the HEA." *Armstrong I*, 832 F. Supp. at 429.

Under *California Federal Savings and Loan Ass'n v. Guerra*, 479 U.S. 272, 280-81, 93 L. Ed. 2d 613, 107 S. Ct. 683 (1987), preemption occurs if: (1) Congress has expressly declared that state law is preempted; (2) a Congressional intent to "occupy the field" can be inferred because the scheme of regulation is so comprehensive as to preclude the application of state law; (3) state law conflicts with federal law such that

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[3] The fact that plaintiff may elect to assert claims under California law does not necessarily mean that she is entitled to the remedies she seeks. She would still need to prove that her state law claims are not preempted by the HEA, and overcome whatever other hurdles California law presents in stating a claim upon which relief may be granted.

compliance with both is either a physical impossibility, or the state law would stand as an obstacle to the accomplishment of the purposes and objectives of the federal law.

In *Armstrong I*, this court concluded that the HEA neither explicitly nor implicitly preempts all of state law. *Armstrong I*, 832 F. Supp. at 428 (citing *Tipton v. Secretary of Education*, 768 F. Supp. 540 (S.D. W. Va. 1991); *see also Jackson v. Culinary School of Washington*, 788 F. Supp. 1233, 1244-46 (D.D.C. 1992) ("*Jackson I*")). Subsequent decisions have reaffirmed this conclusion. *See, e.g., Keams v. Tempe Technical Institute, Inc.*, 39 F.3d 222, 225 (9th Cir. 1994) (holding that the HEA does not expressly preempt state common law tort claims against accreditors); *Crawford v. American Institute of Professional Careers, Inc.*, 934 F. Supp. 335, 339 (D. Ariz. 1996). Therefore, possible pre-emption of state law by the HEA is a consideration only in cases in which it is either impossible for an individual to abide by both state law and the HEA, or where state law precludes execution of the purposes and objectives of the HEA. *See Armstrong I*, 832 F. Supp. 419 at 429; *Keams*, 39 F.3d at 226-27; *Crawford*, 934 F. Supp. at 339-41.

At this juncture, this court's review of whether the appropriate statutory law is preempted must come to its end, as the court is not currently presented with any California statutory law with which to undertake the necessary analysis. This court will review the pre-emption questions as directed by the Court of Appeals if plaintiff elects to amend her complaint by alleging violations of California consumer protection laws.

IV. PLAINTIFF'S CLAIMS BASED UPON MISTAKE AND ILLEGALITY

California does recognize the common-law doctrines of mistake and illegality. See Cal. Civ. Code § 1576-78 (mistake), 1598-99 (illegality) (West 1982). Therefore, these two claims survive this court's determination that California law applies to the loan agreement.

As plaintiff states in her Opening Memorandum, "there is no need to choose between District of Columbia and California law with respect to plaintiff's claims based on common law principles, because there is no conflict between the potentially applicable state laws on these common law issues." Plaintiff's Opening Memorandum at 16. Because there is little difference between the District of Columbia and California on these common-law causes of action, the court's analysis from *Armstrong I* will be applied to these claims on remand. Consequently, this court will again dismiss plaintiff's claims based upon mistake and illegality.

The essence of plaintiff's mistake and illegality claims against CSLFC/BA, HEAF and the Secretary is that NBS did not meet the requirements for an "eligible institution" as defined under 20 U.S.C. § 1085(a) at the time plaintiff received her GSL because NBS's accreditation had expired on May 31, 1987. *See* 28 U.S.C. § 1085(c)(4) (addressing accreditation of vocational schools). As either an illegal contract, or one based on mistake, it would be voidable by plaintiff. Plaintiff grounds her claim in the language of 34 C.F.R. § 600.40(a)(1)(i), which states that an institution loses its eligibility on the date that it fails to meet any of the Department's eligibility requirements. Plaintiff alleges that it is the June 1, 1987 date on which the school first failed to satisfy the financial responsibility requirements of 34 C.F.R. §

668.13 that should be determinative, and, because her enrollment post-dated that time, the contract is voidable.

In *Armstrong I*, this court held that plaintiff misconstrued the manner in which an institution loses its eligibility, explaining that, under 34 C.F.R. § 668, a school's loss of eligibility cannot precede requisite procedural due process, including notification of the offending school, a hearing before an administrative law judge and even a possible appeal to the Secretary. *Armstrong I*, 832 F. Supp. 419 at 426. Additionally, 34 C.F.R. § 668.94 ("Termination") provides only for prospective changes, proscribing future acts by the institution such as making new obligations, or making further guarantee commitments. The retroactive effect prayed for by plaintiffs was held to be contrary to the plain language of the regulation. *Armstrong I*, 832 F. Supp. at 426-27.

Even if this court could be convinced that it had erred on the question of retroactivity, plaintiff would still be unable to advance her illegality or mistake claims as a matter of law. The Department of Education has issued a definitive statement as to whether student loans may retroactively become invalid upon a school's loss of accredited status:

> ED [the Department] considers the loss of institutional eligibility to affect directly only the liability of the institution for Federal subsidies and reinsurance paid on these loans. In either case, the borrower retains all the rights with respect to loan repayment that are contained in the terms of the loan agreements, and ED does not suggest that these loans, whether held by the institution or the lender, are legally unenforceable merely because they were made after the effective date of the loss of institutional eligibility.

58 Fed. Reg. 13,337 (1993). The concept of retroactivity under 34 C.F.R. 600.40(a) is a matter that impacts only the relationship between the school and DOE, not the school and the student, nor the student and DOE. "The regulations [34 C.F.R. §§ 600.40(a), 668.94(b)] are not intended to create any other rights for student borrowers or to suggest that borrowers are excused from repaying loans received to attend that institution." 58 Fed. Reg. 13,337 (1993). If NBS was in fact accredited at the time plaintiff Armstrong entered into her loan contract -- and both sides concede that it was -- then the inquiry as to whether plaintiff's ıoan contract was based upon mistake or illegality comes to its end. For purposes of determining the validity of plaintiff's loan, the court is directed to take a snapshot of the world as it existed at time of plaintiff's enrollment, and, in this case, the school was accredited by ACCET. If that accreditation was improvidently granted, that is a matter of concern between the school and DOE, not between plaintiff and the lenders and guarantors she has named as defendants.

Plaintiff's request that this court again consider its holding on procedural due process in light of *Beth Rochel Seminary v. Bennett*, 263 U.S. App. D.C. 341, 825 F.2d 478 (D.C. Cir. 1987) does not significantly advance her argument. In *Beth Rochel*, DOE sought to recover financial aid funds improperly received by Beth Rochel Seminary because the Department determined that the school did not qualify for participation in the federal program. The Court of Appeals held "the regulation provides that a right to notice and hearing 'does not apply to a determination that . . . an institution of higher education fails to meet the statutory definition set forth in section [] . . . 1201 of the Higher Education Act.' 34 C.F.R. § 668.-71(c)(1)(1986)." 825 F.2d at 481. Even if plaintiff's claim that procedural due process is not required to retroactively terminate accredited status, Beth Rochel still only addresses a school's responsibility

to make restitution to DOE of funds received. Plaintiff's logical leap from Beth Rochel that, "likewise, under the doctrines of mistake and illegality, NBS's failure to satisfy this essential condition of the loan contracts makes plaintiff's contractual obligations void and unenforceable" is simply too great. Plaintiff's Opening Memorandum at 32. The fact that the school in Beth Rochel had to make restitution to the Department does not ipso facto prove that defendants here must make restitution to plaintiff, especially in light of the DOE's statement from the Federal Register set out above. The rights of DOE against a school is not neatly analogous to the rights of students against third party lenders and guarantee agencies, as the regulatory structure and case law make clear.

Having dismissed the mistake and illegality claims on the above grounds in *Armstrong I*,[4] this court originally declined to address defendant's claim that the HEA preempts these common-law defenses. The court did state in a footnote, "Should the court have analyzed the issue, it would have determined that allowing plaintiff to raise these defenses certainly would have such a deleterious effect on the GSL program, as discussed in Part IV.B., below, that the court would have found it necessary to preempt these claims." *Armstrong I*, 832 F. Supp. at 427 n.17. As the Court of Appeals has specifically directed the court to consider the extent to which state law is preempted by the HEA, this court will now address this issue.

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[4] This court also dismissed plaintiff's claims based upon mistake and illegality because allocation of the risk of mistake on BA/CSLFC, HEAF and the Secretary was "unwarranted and unjust." As nothing from the Court of Appeals' opinion affects this analysis, there is no need to revisit this territory.

The HEA expressly vests the Secretary of Education with exclusive authority to determine the existence, scope and duration of a school's eligibility under HEA programs. 20 U.S.C. § 1099c(a). While the Secretary has the authority to decide whether a particular accreditor's standards warrant approval as a reliable indicator of educational quality, 20 U.S.C. § 1099b(a), the Department itself is barred from interfering in an accrediting agency's assessment regarding individual schools. 20 U.S.C. § 3403(b). This structure for determining whether a school is an "eligible institution" for GSL purposes -- involving a carefully-crafted balance between the role of the Secretary and the role of the accreditor -- has been affirmatively established by Congress. Were this court to allow plaintiff to proceed on her mistake and illegality claims, this court would be placed in the position of having to determine if, at the time of the signing of the loan contract, eligibility requirements were met despite the fact that NBS was accredited by ACCET. For plaintiff to prevail, this court would have to substitute its judgment for ACCET's and conclude that accreditation was improperly granted. To place the court in this role would be contrary to clear Congressional intent. The courts would become the ultimate arbiters of eligibility, called upon to make fact-based determinations that are best made by experts in the field -- professional accreditors. Because state law claims based upon mistake and illegality would require the courts to enter the educational evaluation business, and Congress has by statute provided that the Secretary via accrediting agencies are to make these determinations, the state law claims conflict with the federal claim, and are thereby preempted.[5]

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[5] This preemption analysis may affect plaintiff's open claim against ACCET. Because one of the elements of common-law fraud is proof of a false representation, *Blake Construction*

Plaintiff's common-law claims must also be dismissed on preemption grounds because the purposes of the HEA would be frustrated if plaintiff's state law claims of mistake and illegality were allowed to go forward merely because the school should not have been accredited at the time of her matriculation. *See Guerra*, 479 U.S. at 281. In fact, the effects could be devastating. Upon graduation and receipt of a diploma from an otherwise meritorious institution, a student could review the school's financial data at the time of enrollment, seize upon a technical violation of the accreditation rules, and assert a claim that her loan contract was thereby illegal or mistaken.

For example, under 20 U.S.C. § 1099c(c)(2) & 34 C.F.R. § 668.15, a school must maintain prescribed asset-to-liability ratios, operating fund deficits, and the like. Under plaintiff's theory of mistake and illegality, a student could avoid subsequent loan payments if that student could successfully demonstrate to a court of law that the ratio fell below prescribed levels (or the operating deficit rose too high) at the time the student's loans were executed even if the deficiency was not detected at the time by an accrediting agency. Or, theoretically, a student could try to proceed with a claim of supervening illegality if a school's accreditation requirements were not

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Co. v. C.J. Coakley, Co., 431 A.2d 569, 577, this court or a jury may find itself in the position of having to determine whether the school did not meet the requisite accreditation standards during the period of automatic extensions. This would be the exact form of second-guessing that a court is to avoid. Conversely, because proof of fraud also requires "knowledge of falsity," preemption may not be an issue; preemption may not eliminate state law causes of action based on intentional or reckless deceitful acts.

maintained at any time during the student's enrollment period. This potential result is all the more troubling because many of the statutory and regulatory criteria governing schools have only a tangential relationship to educational quality from the perspective of the student. For example, there are requirements proscribing a school from having more than 50% of its students enrolled in correspondence courses, or more than 50% of an admissions class composed of students who lack high school diplomas or the recognized equivalent. 20 U.S.C. §§ 1088(a)(3)(B) & (a)(3)(D). Accreditation requirements, while developed for the overall benefit of students, are, at their core, a matter between the institution and the DOE and usually are related more to finances than pedagogy. The possibility of students avoiding their loan obligations through canvassing for accreditation violations cautions against creating a private right of action under the HEA, and, in the same vein, disallowing the same private enforcement through the "back door" route of common-law causes of action.

Were such claims to go forward, it would surely be followed quickly by the exit of many lenders from the GSL program. Banks and guaranty agencies would likely be far less generous if they knew their obligations could be cut off via technical violations of accreditation requirements. This result would "preclude the execution and purposes and objectives of the HEA," which is to make funds widely available for students who otherwise cannot afford the opportunities higher education promises. *See* 20 U.S.C. § 1070(a) ("It is the purpose of this part, to assist in making available the benefits of postsecondary education to eligible students in institutions of higher education"); 1980 U.S. Code Cong. & Admin. News p. 3168; 1976 U.S. Code Cong. & Admin. News p. 4731 (recognizing the "massive contribution to financing post-secondary educational opportunities made in the ten years of the operation

of the GSLP"). There is a reason why Congress has elected to not create a private right of action under the HEA, and this court refuses to disturb that rationale. To the extent that a resort to state law claims would seriously frustrate Congress' goal of making loans widely available to students while at the same time making participation in this program attractive to lenders, such state law claims must be deemed as preempted. *Accord, Morgan v. Markerdowne Corp.*, 976 F. Supp. 301, 1997 U.S. Dist. LEXIS 13665, at 46 (D.N.J. 1997).

For the above reasons, plaintiff's state law claims based on the doctrines of mistake and illegality against BA/CSLFC, HEAF and the Secretary must be dismissed.

V. PLAINTIFF'S ORIGINATION CLAIM AGAINST THE SECRETARY

Having addressed the specific issues posed by the Court of Appeals, this court will note that plaintiff's claims for relief against BA/CSLFC and HEAF -- all of which were dismissed in *Armstrong I* -- are wholly unaffected by the resolution of the choice of law or preemption questions. Nonetheless, both plaintiff and defendants have dedicated substantial portions of their briefs on remand to issues that were definitively resolved in 1993, most notably claims arising under the FTC Holder Rule.

In *Armstrong I* this court concluded, consistent with the weight of authority, that the FTC Holder Rule, 16 C.F.R. § 433.2, affords plaintiff with no basis for asserting claims and defenses against defendants because the requisite notice was not part of the loan contract. And, even if the Holder Rule's notice was implied into the contract, there would still be no power to grant relief because violations of the Holder Rule do not furnish

private parties with a cause of action. *See Armstrong I*, 832 F. Supp. at 431-33 (citing *Holloway v. Bristol-Myers Corp.*, 158 U.S. App. D.C. 207, 485 F.2d 986 (D.C. Cir. 1973)). Subsequent decisions have only reinforced this court's resolution of that question. *See Bartels v. Alabama Commercial College*, 918 F. Supp. 1565, 1570 (S.D. Ga. 1995) ("Even assuming that the FTC Holder Rule applies to student loan transactions, a plaintiff has no rights under the rule if the notice is omitted from the contract. Furthermore, there is no private cause of action under the FTC Holder Rule. . . . enforcement of the rule is the sole province of the Federal Trade Commission.") (citations omitted); *Markerdowne*, at 25. ("Notwithstanding the conclusion that the FTC Holder Rule was applicable to plaintiff's student loans, the parties agree that violation of the rule does not give rise to a federal private cause of action.").

Furthermore, plaintiff's "origination" claims allegedly arising under 34 C.F.R. § 682.200 against third-party defendants BA/CSLFC and HEAF and do not need to be reanalyzed in light of the Court of Appeals' vacating and remanding of the earlier judgment. The Secretary's "unofficial policy" of not enforcing loans which are the product of an origination relationship is not binding on third parties, *see Armstrong I*, 832 F. Supp. at 433-34, and plaintiff therefore cannot assert claims and defenses against these parties, even if such a relationship could be proven. Again, subsequent holdings of other courts have buttressed this court's determination that the Secretary's policy of forbearing enforcement of loans when an origination relationship exists cannot be used against lenders and guaranty agencies such as (BA/CSLFC and HEAF) because the APA's rulemaking procedures were not followed in creating the "policy." *See Bartels*, 918 F. Supp. at 1570; *Williams v. National Sch. of Health Tech.*, 836 F. Supp. 273, 284-85 (E.D. Pa. 1993) ("Although an agency may choose to bind itself in an informal

matter, it cannot regulate third parties other than by utilizing the mechanisms of the APA established for that purpose.") (citation omitted).

Consequently, the only origination claim remaining is against the Secretary. In Armstrong I, the Secretary did not move to dismiss plaintiff's claims based on an alleged origination relationship. *See Armstrong I*, 832 F. Supp. at 433-34. In his Renewed Motion to Dismiss, the Secretary now seeks to dismiss the origination claims. As the D.C. Circuit has now affirmatively determined that a student does not have a cause of action against the Secretary based on the Secretary's non-enforcement "policy," this court will grant the Secretary's motion to dismiss.[6]

Under 34 C.F.R. § 682.200, an "origination relationship" is a relationship between a school and a lender in which the lender delegates to the school "substantial functions" in the execution of the loan that are normally performed by the lender. Specifically, this "origination relationship" exists where:

> (1) A School determines who will receive a loan and the amount of the loan;
>
> (2) The lender has the school verify the identify of the borrower or complete forms normally completed by the lender.

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[6] Claims based on the alleged origination relationship between FITCO and NBS against the Secretary were dismissed without prejudice by this court's Order of July 25, 1997. Because this order was vacated by the Court of Appeals in *Armstrong II*, this court will again address this claim.

In cases in which an origination relationship exists, the Secretary has a long-standing policy of abstaining from collection. *See, e.g.*, 55 Fed. Reg. 48,327 (1990); Letter from Kenneth D. Whitehead, Acting Assistant Secretary of Education, to Stephen J. Solarz, House of Representatives (May 19, 1988). Plaintiff now wishes to convert this policy into a federal cause of action against the Secretary.

In *Jackson v. Culinary School of Washington, Ltd.*, 307 U.S. App. D.C. 123, 27 F.3d 573 (D.C. Cir. 1994) ("Jackson II"), fifty-nine former students sought declaratory and injunctive relief against various lenders, guarantee agencies and the Secretary for the actions of the defunct and judgement-proof Culinary School of Washington. Included in plaintiffs' complaint was a claim against the Secretary based upon an alleged origination relationship. The threshold issue considered by the Court of Appeals was as to whether there was a "federally grounded right to enforce the Secretary's alleged promise [to abstain from collections]." 27 F.3d at 583.

In *Jackson II*, the Department conceded its longstanding policy to refrain from enforcing student loans in cases where the lenders and schools were in an origination relationship. *Id.* at 585 (citing *Armstrong I*, 832 F. Supp. at 433-35). The court noted that, in determining whether an agency's "promise" is enforceable by third parties, the relevant inquiry is agency intent. *See* 27 F.3d at 584 (citing *National Latino Media Coalition v. FCC*, 259 U.S. App. D.C. 481, 816 F.2d 785, 788 n.2 (D.C. Cir. 1987) ("the 'binding' quality of a particular rule or statement will depend on whether the agency intended to establish a 'substantive' rule . . . ."). *Quoting Vietnam Veterans v. Secretary of the Navy*, 269 U.S. App. D.C. 35, 843 F.2d 528, 537 (D.C. Cir. 1988), the Court of Appeals next stated, "statements whose language, context and application suggest an

intent to bind agency discretion and private party conduct -- the sort of statements requiring compliance with [APA] § 553 -- will have that effect if valid; interpretive rules or policy statements will not, regardless of their validity.'" *Id.*

As to whether the Secretary's "rule" was meant to create substantive rights in third parties, the court first cited the Secretary's position - as described in *Armstrong I* -- that "where there is an origination relationship between the school and the lender, the student's claims and defenses as to the school can be asserted as defenses to the loan contract . . . ." *Jackson II*, 27 F.3d at 585. However, on the other side of the balance, the court noted that there had been a proposed regulation on borrower defenses that would have codified the Secretary's policy, 55 Fed. Reg. 48,327 (1990), but this proposal was never adopted by DOE, and, in fact, was explicitly rejected. See 57 Fed. Reg. 60,304 (1992) ("the Secretary has decided that it is not desirable at this time to prescribe in regulations a uniform Federal rule regarding borrower defenses that would preempt State law otherwise applicable to FFEL [GSL] programs").[7]

Balancing the arguments in favor of and against creating a substantive cause of action based upon an alleged origination relationship, the Jackson II court concluded, "the Secretary has

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[7] This discussion in the Federal Register does identify "four kinds of State laws whose application would not frustrate FFEL program policies and are therefore not preempted by federal law." However, since plaintiff has not pleaded any claims under California law, this court's analysis must presently end upon determining that there is no federal claim against the Secretary based upon an origination relationship.

not sufficiently communicated an intention to be bound by his origination policy so as to create a legally enforceable right grounded in federal law." *Jackson II*, 27 F.3d at 585. Additionally, the court opined:

> The paltry fragments suggesting the Department's intent, the amorphous language and unrelated context of the letters, and, finally, the Department's indication in 1992 that it preferred continuation of the regime of state defenses to the promulgation of a uniform federal rule all suggest to us the manifest impropriety of deeming the origination-forbearance policy enforceable by appellants as a matter of federal law.

Id. Other jurisdictions have subsequently been in accord with *Jackson II*'s conclusion that there is no federal cause of action against the Secretary based upon an alleged origination relationship. In *Bartels*, 918 F. Supp. at 1572, the court considered whether the Secretary's informal policy could be used as a defense to a loan obligation. That court, in accord with *Jackson II*, held, "The Secretary's policy was that the Department of Education would refrain from trying to enforce unenforceable loans, not that an origination relationship creates a private cause of action for breach of contract." *Id.* at 1573. Similarly, in *Williams*, 836 F. Supp. at 285, the court concluded that the Secretary's policy does not afford plaintiff relief against the Secretary. "The Secretary has not indicated that the Department of Education would actively discharge loans based on the existence of an origination relationship but merely that the Secretary would not seek to enforce such loans."

Consistent with this Circuit's holding in *Jackson II*, and the weight of authority from other jurisdictions, plaintiff's federal claim against the Secretary based upon an origination

relationship must be dismissed.

VI. PLAINTIFF'S CLAIM AGAINST THE SECRETARY TO PERFORM ITS STATUTORY DUTY PURSUANT TO 20 U.S.C. § 1087(c)(1)

In *Armstrong I*, this court took note of the seemingly curious fact that this suit persisted despite Congress's passage of 20 U.S.C. § 1087(c). This statute reads:

> If a borrower who received, on or after January 1, 1986, a loan made, insured, or guaranteed under this part and the student borrower, or the student on whose behalf a parent borrowed, in unable to complete the program in which such student is enrolled due to the closure of the institution or if such student's eligibility to borrow under this part was falsely certified by the eligible institution, then the Secretary shall discharge the borrower's liability on the loan (including interest and collection fees) by repaying the amount owed on the loan and shall subsequently pursue any claim available to such borrower against the institution and its affiliates and principals or settle the loan obligation pursuant to the financial responsibility authority under subpart 3 of part G.

Plaintiff now, in her amended complaint, asserts that the Secretary has failed to perform his duty under this statute by not discharging the loans and by failing to notify local credit bureaus of such a discharge. Plaintiff asks this court to enter a declaratory judgment and issue a writ of mandamus compelling

the Secretary to act in accordance with § 1087(c)(1).[8]

While plaintiff has identified her proper source of relief due to the school's failure to deliver on the education it promised, she has not pursued the proper means for obtaining such relief. Section 1087(c)(1), while enacted for the benefit of students whose schools close prior to the student's completion of the course of study, does not create a private cause of action. *Bega v. United States Department of Education*, 180 B.R. 642 (Bankr. D. Kan. 1995) (determining that 20 U.S.C. § 1087(c) does not present an alternative means for a bankruptcy court to discharge student loan obligations when other means of discharge are not available).

The proper mechanism for obtaining discharge of a loan obligation when a student's school closes is administrative -- as per 34 C.F.R. § 685.213(c). This regulation requires a borrower to submit to the Secretary a "written and sworn statement" attesting that the student received the proceeds of the loan and that the student did not complete the program due to closure of the school. The student must also list other claims asserted with respect to the school's closure, and agree to cooperate with and provide information to the Secretary.

At least one federal court has reached an identical conclusion as to whether a private right of action could be implied under 20 U.S.C. § 1087(c)(1) in an action similar to the instant case. In Williams, the court concluded:

---

[8] This claim was initially dismissed as per this court's order of July 25, 1995, but, pursuant to the Court of Appeals' vacating of this order in *Armstrong II*, this court will now address this claim in greater detail.

> It is uncontested that the loan discharge provisions were enacted for the benefit of students such as the plaintiff. That conclusion alone, however, is not sufficient to imply a right of action to enforce the provisions. Where a statute provides an administrative enforcement mechanism, it is presumed that Congress did not mean to create a private right of action.

836 F. Supp. at 279 (cited in *Bega*, 180 B.R. at 643.) *Cf. Touche Ross v. Redington*, 442 U.S. 560, 61 L. Ed. 2d 82, 99 S. Ct. 2479 (1979) (holding that federal courts should only create private rights of action when there exists affirmative evidence of Congressional intent to do so).

As plaintiff's amended complaint demonstrates no evidence that she has availed herself of her administrative remedies as outlined above, this court cannot and will not perform the duty that Congress has expressly delegated to the Secretary -- the discharge of student loans under 20 U.S.C. § 1087.

VII. CONCLUSION

In their briefing of the issues on remand, plaintiff and defendants conflict over whether this case centers around creating a cause of action against third party lenders and guarantors for "educational malpractice." While this court does not agree with all of defendants' assertions that plaintiff is, through this suit, attempting to assert such a claim, it is undeniable that plaintiff is trying to obtain rescission of her loan agreement based upon her dissatisfaction with the quality of the education she received. As this court concluded in *Armstrong I*, if there was any wrongdoing in this case, it was the wrongdoing of NBS, as NBS is the only party who owed a duty of care to plaintiff as to receiving a promised education in the field of

automotive repair. The defendants in this case -- BA/CSLFC, HEAF and the Secretary -- have acted entirely in accord with the mandates of law.

In the absence of the Guaranteed Student Loan program, the opportunities available through higher education would be beyond the reach of many, if not most, students who seek the chance to better their station in life. To subject lenders to suit based on acts of the educational institutions would surely lead lenders to cease their participation in student loan programs. Most, if not all, courts who have considered the types of claims raised by plaintiff against "the usual suspects", have been vigilant in protecting the GSL and other student loan programs. This court will not depart from the path it took three years ago, and has been taken by almost all of those who have embarked upon this long journey.

Accordingly, the motions to dismiss will be granted in full.

A separate order shall issue this date.

Royce C. Lamberth
United States District Court

Filed Sept 30 1997

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA
C.A. No. 91-3135 RCL

VANESSA ARMSTRONG,

Plaintiff,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION & TRAINING, INC., *et al.*,

Defendants.

ORDER

This case comes before the court on the renewed motions to dismiss of defendants Bank of America, California Student Loan Finance Corporation, Higher Education Assistance Foundation and the Secretary of Education. Upon consideration of the filings of counsel and the relevant law, and for the reasons stated in the accompanying Memorandum Opinion, it is hereby ORDERED that:

1. The motion to dismiss filed by defendants Secretary of Education and Higher Education Assistance Foundation of January 28, 1997 is GRANTED; the second, third and fourth claims for relief are DISMISSED as to the HIGHER EDUCATION ASSISTANCE FOUNDATION and the SECRETARY. The second amended, third amended and fourth amended claims for relief are DISMISSED as to the

SECRETARY.

2. The motion to dismiss filed by defendants Bank of America and California Student Loan Finance Corporation of January 27, 1997 is GRANTED; the second, third, and fourth claims for relief are DISMISSED as to these defendants.

3. Defendant California Student Loan Finance Corporation's motion for protective order is DENIED AS MOOT.

4. Plaintiff's motion to compel production of documents is DENIED AS MOOT.

5. Plaintiff's motion to substitute the Educational Credit Management Corporation as defendant is GRANTED and the Educational Credit Management Corporation shall hereafter be substituted for the Higher Education Assistance Foundation as defendant herein.

6. A status call on plaintiff's and class claims against the Accrediting Council for Continuing Education & Training, Inc. is scheduled for 4:30 p.m. on Wednesday, October 15, 1997.

SO ORDERED.

Royce C. Lamberth
United States District Court
Date: 9-30-97

Filed Oct 31, 1997

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

C.A. No. 91-3135 RCL

VANESSA ARMSTRONG,

Plaintiff,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION & TRAINING, INC., *et al.*,

Defendants.

ORDER

Upon consideration of Plaintiff's Motion to Amend Judgment and Motion for Entry of Final Judgment Pursuant to Fed. R. Civ. P. 54(b), and the response thereto, the Court finds that the Memorandum Opinion and Order of September 30, 1997 should be amended as described below, and that there is no just reason for delay entering final judgment dismissing plaintiff's claims against defendants Secretary of Education, Bank of America NT&SA, California Student Loan Finance Corporation, and Higher Education Assistance Foundation and Transitional Guaranty Agency. The claims against these defendants are separable from the fraud claim that remains to be adjudicated against the Accrediting Council for Continuing Education and Training, and this Court's decision to dismiss these claims rests on purely legal issues that can be presented to

the Court of Appeals without interfering with the litigation of the remaining claim in this Court. Moreover, there is a danger of hardship if appeal is delayed until the remaining claims are finally adjudicated because of the penalties and sanctions imposed for failure to repay contested student loans. Defendants will not be prejudiced by entry of a final judgment. Thus, both judicial administrative interests and the equities involved favor entry of a final judgment. Therefore, it is hereby, this ____ day of _____, 1997,

ORDERED that plaintiff's motion to amend is granted; and it is further

ORDERED that Section VI of the Court's Memorandum Opinion of September 30, 1997 is hereby withdrawn and the last sentence of paragraph 1 of the Court's Order of September 30, 1997 is amended to read: "The third amended and fourth amended claims for relief are dismissed as to the SECRETARY."; and it is further

ORDERED that the second sentence of footnote 7 of the Court's Memorandum Opinion of September 30, 1997 is hereby amended to read: "However, since plaintiff has not pleaded any claims under California statutory law, this court's analysis must presently end upon determining that there is no *federal* claim against the Secretary based upon an origination relationship."; and it is further

ORDERED that the Clerk is directed to enter final judgment dismissing the Second, Third, and Fourth Claims for Relief in plaintiff's complaint of December 10, 1991, because this Court determines that there is no just reason for delay in entering final judgment with respect to this Court's decision of September 30, 1997, because the claims that the Court has

dismissed as a matter of law are separable from the claims that remain to be adjudicated in this action, and there is a danger of hardship if appeal is delayed until the remaining claims are finally adjudicated.

_____ 10/30/97

Royce C. Lamberth
United States District Court Judge

Truth in Lending Act

15 USC § 1603 Exempted transactions

(as amended by Pub. L. 97-320, title VII, § 701(a), Oct. 15, 1982, 96 Stat.1538)

This subchapter does not apply to the following:

* * *

(7) Loans made, insured, or guaranteed pursuant to a program authorized by title IV of the Higher Education Act of 1965 (20 U.S.C. 1070 et seq., 42 U.S.C. 2751 et seq.).

Higher Education Act of 1965

20 U.S.C. § 1077. Eligibility of student borrowers and terms of federally insured student loans (1988)

(a) *List of requirements.* Except as provided in section 1078-3, a loan by an eligible lender shall be insurable by the Secretary under the provisions of this part only if--

(1) made to a student who (A) is an eligible student under section 1091, (B) has agreed to notify promptly the holder of the loan concerning any change of address, and (C) is carrying at least one-half the normal full-time academic workload for the course of study the student is pursuing (as determined by the institution); and

(2) evidenced by a note or other written agreement which--

(A) is made without security and without endorsement;

(B) provides for repayment (except as provided in subsection (c)) of the principal amount of the loan in installments over a period of not less than 5 years (unless sooner repaid or unless the student, during the 6 months preceding the start of the repayment period, specifically requests that repayment be made over a shorter period) nor more than 10 years beginning 6 months after the month in which the student ceases to carry at an eligible institution at least one-half the normal full-time academic workload as determined by the institution, except--

(i) as provided in subparagraph (C);

(ii) that the note or other written instrument may contain such reasonable provisions relating to repayment in the event of default in the payment of interest or in the payment of the cost of insurance premiums, or other default by the borrower, as may be authorized by regulations of the Secretary in effect at the time the loan is made; and

(iii) that the lender and the student, after the student ceases to carry at an eligible institution at least one-half the normal full-time academic workload as determined by the institution, may agree to a repayment schedule which begins earlier, or is of shorter duration, than required by this subparagraph, but in the event a borrower has requested and obtained a repayment period of less than 5 years, the borrower may at any time prior to the total repayment of the loan, have the repayment period extended so that the total repayment period is not less than 5 years; (C) provides that periodic installments of principal need not be paid, but

interest shall accrue and be paid, during any period--

(i) during which the borrower--

(I) is pursuing at least a half-time course of study as determined by an eligible institution; or

(II) is pursuing a course of study pursuant to a graduate fellowship program approved by the Secretary, or pursuant to a rehabilitation training program for individuals with disabilities approved by the Secretary, except that no borrower shall be eligible for a deferment under this clause, or a loan made under this part (other than a loan made under 1078-2 or 1078-3), while serving in a medical internship or residency program;

(ii) not in excess of 3 years during which the borrower is seeking and unable to find full-time employment; or

(iii) not in excess of 3 years for any reason which the lender determines, in accordance with regulations prescribed by the Secretary under section 1085(o), has caused or will cause the borrower to have an economic hardship;
and provides that any such period shall not be included in determining the 10-year period described in subparagraph (B);

(D) provides for interest on the unpaid principal balance of the loan at a yearly rate, not exceeding the applicable maximum rate prescribed in section 1077a, which interest shall be payable in installments over the period of the loan except that, if provided in the note or other written agreement, any interest payable by the student may be deferred until not later than the date upon which repayment of the first installment of principal falls due, in which case interest accrued during that period may be added on that date to the principal;

(E) provides that the lender will not collect or attempt to collect from the borrower any portion of the interest on the note which is payable by the Secretary under this part and that the lender will enter into such agreements with the Secretary as may be necessary for the purpose of section 1087;

(F) entitles the student borrower to accelerate without penalty repayment of the whole or any part of the loan;

(G) (i) contains a notice of the system, of disclosure of information concerning such loan to credit bureau organizations under section 1080a, and (ii) provides that the lender on request of the borrower will provide information on the repayment status of the note to such organizations;

(H) provides that, no more than 6 months prior to the date on which the borrower's first payment on a loan is due, the lender shall offer the borrower the option of repaying the loan in accordance with a graduated or income-sensitive repayment schedule established by the lender and in accordance with the regulations of the Secretary; and

(I) contains such other terms and conditions, consistent with the provisions of this part and with the regulations issued by the Secretary pursuant to this part, as may be agreed upon by the parties to such loan, including, if agreed upon, a provision requiring the borrower to pay the lender, in addition to principal and interest, amounts equal to the insurance premiums payable by the lender to the Secretary with respect to such loan;

(3) the funds borrowed by a student are disbursed to the institution by check or other means that is payable to and requires the endorsement or other certification by such student, except--

(A) that nothing in this title shall be interpreted--

(i) to allow the Secretary to require checks to be made copayable to the institution and the borrower; or (ii) to prohibit the disbursement of loan proceeds by means other than by check; and

(B) in the case of any student who is studying outside the United States in a program of study abroad that is approved for credit by the home institution at which such student is enrolled, the funds shall, at the request of the borrower, be delivered directly to the student and the checks may be endorsed, and fund transfers authorized, pursuant to an authorized power-of-attorney; and

(4) the funds borrowed by a student are disbursed in accordance with section 1078-7.

(b) *Special rules for multiple disbursement.* For the purpose of subsection (a)(4)--

(1) all loans issued for the same period of enrollment shall be considered as a single loan; and

(2) the requirements of such subsection shall not apply in the case of a loan made under section 1078-2 or 1078-3, or made to a student to cover the cost of attendance at an eligible institution outside the United States.

(c) *Special repayment rules.* Except as provided in subsection (a)(2)(H), the total of the payments by a borrower during any year of any repayment period with respect to the aggregate amount of all loans to that borrower which are insured under this part shall not, unless the borrower and the lender otherwise agree, be less than $ 600 or the balance of all such loans (together with interest thereon), whichever amount is less (but in no instance less than the amount of interest due and payable).

(d) *Borrower Information.* The lender shall obtain the borrower's driver's license number, if any, at the time of application for the loan.

20 U.S.C. § 1078. Federal payments to reduce student interest costs (1988)

(a) **Federal interest subsidies.**

(1) *Types of loans that qualify.* Each student who has received a loan for study at an eligible institution--

(A) which is insured by the Secretary under this part; or

(B) which is insured under a program of a State or of a nonprofit private institution or organization which was contracted for, and paid to the student, within the period specified in paragraph (5), and which--

(i) in the case of a loan insured prior to July 1, 1967, was made by an eligible lender and is insured under a program which meets the requirements of subparagraph (E) of subsection (b)(1) and provides that repayment of such loan shall be in installments beginning not earlier than 60 days after the student ceases to pursue a course of study (as described in subparagraph (D) of subsection (b)(1)) at an eligible institution, or

(ii) in the case of a loan insured after June 30, 1967, was made by an eligible lender and is insured under a program covered by an agreement made pursuant to subsection (b), shall be entitled to have paid on his or her behalf and for his or her account to the holder of the loan a portion of the interest on such loan under circumstances described in paragraph (2).

(2) *Additional requirements to receive subsidy.*

(A) Each student qualifying for a portion of an interest payment under paragraph (1) shall--

(i) have provided to the lender a statement from the eligible institution, at which the student has been accepted for enrollment, or at which the student is in attendance, which--

(I) sets forth such student's estimated cost of attendance (as determined under section 472;

(II) sets forth such student's estimated financial assistance; and

(III) sets forth a schedule for disbursement of the proceeds of the loan in installments, consistent with the requirements of section 1078-7;

(ii) meet the requirements of subparagraph (B); and

(iii) have provided to the lender at the time of application for a loan made, insured, or guaranteed under this part, the student's driver's number, if any.

(B) For the purpose of clause (ii) of subparagraph (A), a student shall qualify for a portion of an interest payment under paragraph (1) if the eligible institution has provided the lender with a statement evidencing a determination of need for a loan (as determined under part F of this title) and the amount of such need, subject to the provisions of subparagraph (D).

(C) For the purpose of paragraph (1) and this paragraph--

(i) a student's estimated financial assistance means, for the period for which the loan is sought, the amount of assistance such student will receive under subpart 1 of part A (as determined in accordance with section 484(b), subpart 3 of part A, and parts C and E of this title, and any veterans' education benefits paid because of enrollment in a postsecondary education institution, including veterans' education benefits (as defined in section 1087vv(c)), plus other scholarship, grant, or loan assistance.

(ii) the determination of need and of the amount of a loan by an eligible institution under subparagraph (B) with respect to a student shall be calculated in accordance with part E.

(D) An eligible institution may not, in carrying out the provisions of subparagraphs (A) and (B) of this paragraph, provide a statement which certifies the eligibility of any student to receive any loan under this part in excess of the maximum amount applicable to such loan.

(E) For the purpose of subparagraphs (B) and (C) of this paragraph, any loan obtained by a student under section 1078-1 or a parent under section 1078-2 or under any State-sponsored or private loan program for an academic year for which the determination is made may be used to offset the expected family contribution of the student for that year.

(F) Except as provided in subparagraph (D), an eligible institution may refuse to certify a statement which permits a student to receive a loan under this part or to certify a loan amount that is less than the student's determination of need (as determined under part E of this title), if the reason for such action is documented and provided in written form to each student so affected.

* * *

District of Columbia Consumer Credit Protection Act
D.C. Code § 28-3809. Lender subject to defenses arising from sales.

(a) A lender who makes a direct installment loan for the purpose of enabling a consumer to purchase goods or services is subject to all claims and defenses of the consumer against the seller arising out of the purchase of the goods or service if such lender acts at the express request of the seller, and --

(1) the seller participates in the preparation of the loan instruments, or

(2) the lender is a person or organization controlled by or under common control with the seller, or

(3) the seller receives or will receive a fee, compensation, or other consideration from the lender for arranging the loan.

(b) The lender's liability under this section may not exceed the amount of the loan. Rights of the debtor can only be asserted affirmatively in an action to cancel and void the sale from its inception, or as a matter of defense to or set-off against a claim by the lender.

Federal Trade Commission Regulations on Preservation of Consumers Claims and Defenses, 16 C.F.R. § 433

16 C.F.R. § 433.1 Definitions.

(a) *Person.* An individual, corporation, or any other business organization.

(b) *Consumer.* A natural person who seeks or acquires goods or services for personal, family, or household use.

(c) *Creditor.* A person who, in the ordinary course of business, lends purchase money or finances the sale of goods or services to consumers on a deferred payment basis; Provided, such person is not acting, for the purposes of a particular transaction, in the capacity of a credit card issuer.

(d) *Purchase money loan.* A cash advance which is received by a consumer in return for a "Finance Charge" within the meaning of the Truth in Lending Act and Regulation Z, which is applied, in whole or substantial part, to a purchase of goods or services from a seller who (1) refers consumers to the creditor or (2) is affiliated with the creditor by common control, contract, or business arrangement.

(e) *Financing a sale.* Extending credit to a consumer in connection with a "Credit Sale" within the meaning of the Truth in Lending Act and Regulation Z.

(f) *Contract.* Any oral or written agreement, formal or informal, between a creditor and a seller, which contemplates or provides for cooperative or concerted activity in connection with the sale of goods or services to consumers or the financing thereof.

(g) *Business arrangement.* Any understanding, procedure, course of dealing, or arrangement, formal or informal, between a creditor and a seller, in connection with the sale of goods or services to consumers or the financing thereof.

(h) *Credit card issuer.* A person who extends to cardholders the right to use a credit card in connection with purchases of goods or services.

(i) *Consumer credit contract.* Any instrument which evidences or embodies a debt arising from a "Purchase Money Loan" transaction or a "financed sale" as defined in paragraphs (d) and (e) of this section.

(j) *Seller.* A person who, in the ordinary course of business, sells or leases goods or services to consumers.

16 C.F.R. 433.2 Preservation of consumers' claims and defenses, unfair or deceptive acts or practices.

In connection with any sale or lease of goods or services to consumers, in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, it is an unfair or deceptive act or practice within the meaning of section 5 of that Act for a seller, directly or indirectly, to:

(a) Take or receive a consumer credit contract which fails to contain the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD

ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

or,

(b) Accept, as full or partial payment for such sale or lease, the proceeds of any purchase money loan (as purchase money loan is defined herein), unless any consumer credit contract made in connection with such purchase money loan contains the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

Department of Education
Guaranteed Student Loan Program Regulations

(adopted, 51 Fed Reg. 40889 (Nov. 10, 1986);
superseded, 57 Fed Reg. 60279 (Dec. 18, 1992))

34 C.F.R. § 682.200 Definitions

(b) The following definitions also apply to this part:

* * *

Origination: A special relationship between a school and a lender, in which the lender delegates to the school, or to an entity or individual affiliated with the school, substantial functions or responsibilities normally performed by lenders before making loans. In this situation, the school is considered to have "originated' a loan made by the lender. The Secretary determines that "origination' exists if, for example --

(1) A school determines who will receive a loan and the amount of the loan; and

(2) The lender has the school verify the identity of the borrower or complete forms normally completed by the lender.

34 C.F.R. § 682.206(a) Due diligence in making a loan.

(a) *General.*

(1) The loan-making process includes processing the loan application and other required forms, approving the borrower for a loan, determining the loan amount, explaining to the borrower his or her responsibilities under the loan, completing and having the borrower sign the promissory note, and disbursing the loan proceeds.

(2) Except as may be authorized by the Secretary, a lender may not delegate its loan-making functions to a school unless the school has an origination relationship with the lender. If that relationship exists, the lender may rely in good faith upon statements of the borrower contained in the loan application, but may not rely upon statements made by the school in the application. A non-school lender that does not have an origination relationship may rely in good faith upon statements of both the borrower and the school that are contained in the application. Except as provided in Part 668, Subpart E, a school lender may rely in good faith upon statements made by the borrower in the loan application.

(b) *Processing forms.* Before disbursing a loan, a lender must determine that all required forms have been accurately completed by the borrower, the student, the school, and the lender. A lender may not ask the borrower to sign any loan form before all the information requested from the borrower on that form has been supplied.

(c) *Approval of borrower and determination of loan amount.*

(1) A lender may make a loan only to an eligible borrower. To the extent authorized by paragraph (a)(2) of this section, the lender may determine the borrower's eligibility based on the information provided on the application by the school, the borrower, and, if the borrower is a parent, the student on whose behalf the loan is sought.

(2) In determining the amount of the loan to be made, within the limitations of § 682.204, the lender shall review the data on the student's cost of attendance and estimated financial assistance that is provided on the application form. In no case may the loan amount exceed the student's estimated cost of attendance, less estimated financial

assistance, for the academic period for which the loan is intended.

(d) *Promissory note.*

(1) The lender shall obtain from the borrower an executed legally enforceable promissory note for each loan as proof of the borrowers' indebtedness.

(2) A lender may not add any clauses to, or modify any provisions of, the most current promissory note provided by the guarantor without the guarantor's prior approval.

(3) The lender shall give the borrower a copy of each executed note.

(e) *Security, endorsement, and comakers.*

(1) A FISLP or Federal PLUS Program loan shall be made without security or endorsement.

(2) A Federal PLUS Program loan may be made to two eligible parents who agree to be jointly liable for repayment of the loan as co-makers.

(f) *Loan disbursement.* A lender shall disburse funds as required by § 682.207.

DEPARTMENT OF HEALTH, EDUCATION,
AND WELFARE
OFFICE OF EDUCATION
WASHINGTON, DC 20302

June 28, 1996

TO ALL LENDERS AND EDUCATIONAL INSTITUTIONS

SUBJECT: Federal Trade Commission Trade Regulation Concerning Preservation of Consumers' Claims and Defenses

The Federal Trade Commission (FTC) published a Trade Regulation Rule in the *Federal Register* of November 18, 1975 (40 FR 53506) concerning the Preservation of Consumers' Claims and Defenses. The Rule became effective May 14, 1976.

In adopting this rule, the Federal Trade Commission determined that it constitutes an unfair and deceptive practice within the meaning of Section 5 of the Federal Trade Commission Act (15 U.S.C. 45) for a seller, in the course of financing a consumer purchase of goods or services, to employ procedures which make the consumer's duty to pay independent of the seller's duty to fulfill his obligations.

Effect of the Rule

The Rule is designed to insure that consumer credit contracts used in financing the retail purchase of consumer goods or services specifically preserve the consumers' claim and defenses. To achieve this result, it requires a seller to include a prescribed notice in the text of any consumer credit contract which it executes with a buyer. In addition, if a seller arranges

loan financing for his customers from a third party creditor, the Rule prohibits the seller from accepting the proceeds of the loan as payment for the sale, unless the loan contract signed by the buyer contains the prescribed notice.

Applicability of the Rule to the Guaranteed Student Loan Program

In order to determine to what extent this Rule affects the Guaranteed Student Loan Program, the Office of Guaranteed Student Loans has communicated with the staff attorneys of the Federal Trade Commission responsible for drafting the Rule. This bulletin provides preliminary guidance to participants in the Guaranteed Student Loan Program and has been reviewed by these attorneys.

The Rule is applicable to "sellers" when they finance or arrange financing for the sale of consumer goods and services. It appears that all for-profit educational institutions fall within the Rule's definition of "seller" and *are covered*. It appears that the Rule *does not* apply to public institutions.

A question arises, however, with respect to private non-profit institutions. The Rule, by its terms, would cover such institutions, but it does not appear that they fall within the FTC's jurisdiction. In addition, the FTC has not attempted to exercise jurisdiction over non-profit educational institutions that are genuinely not for profit.

For those institutions which are "sellers" under the Rule, the Rule requires inclusion of a notice (set out below) in the loan contract if the institution itself finances the sale of its services. This means that those school lenders within the Rule's coverage are required to include the notice in their student loan notes.

The Rule is also applicable to any covered school which:

(1) "refers" students to a "creditor," or

(2) is affiliated with the creditor by common control, contract, or business arrangement

In these situations, the school is forbidden to accept the proceeds of the loan unless the lender has included the required notice in the loan contract. The definitions of "business arrangement" and "creditor" are set out below.

The FTC's *Staff Guidelines* on the Rule discuss what is meant by referral in this context as follows:

> The word "refers" is intended to reach those situations where a seller, in the ordinary course of the ordinary course of business, is sending his buyers to a particular loan outlet, or to particular outlets, for credit which is to be used in the seller's establishment...
>
> No specific number of referrals is specified in the Rule. The key distinction is between those instances where a seller is merely passing along information about places where his buyers may obtain credit and those where a seller is acting as a conduit for financing and channeling buyer-borrowers to a particular lender or limited group of lenders...
>
> Finally, the test is whether the seller *routinely* [emphasis added] refers his customers to a lender or lenders. It is not whether a particular buyer was referred. This means that once a seller is referring his customers to a lender, all loan contracts between that lender and borrowers from that lender must contain the

> Notice...Conversely, it means that an occasional referral which is not part of a business routine of the seller does not trigger the Rule.

Selected Definitions from the Rule:

Business arrangement: Any understanding, procedure, course of dealing, or arrangement, formal or informal, between a creditor and a seller, in connection with the sale of goods or services to consumers or the financing thereof.

Creditor: A person who, in the ordinary course of business, lends purchase money or finances the sale of goods or services to consumers on a deferred payment basis; *Provided*, such person is not acting, for the purposes of a particular transaction, in the capacity of a credit card issuer.
(Note: it appears that a State agency is not included within this definition.)

Person: An individual, corporation, or any other business organization.

Seller: A person who, in the ordinary course of business, sells or leases goods or services to consumers.

Required Notice When Seller Provides Credit:

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

Required Notice When Creditor Provides Credit as a Result of Business Arrangement Between Seller and Creditor:

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

K.A. Kohl
Associate Commissioner
Office of Guaranteed Student Loans

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

January 9, 1989

Joseph Esposito, Esquire
Heron, Burchette, Ruckert, and Rothwell
1025 Thomas Jefferson Street, N.W.
Washington, D.C. 20007

Dear Mr. Esposito:

Please find enclosed the materials you requested respecting the Federal Trade Commission's Trade Regulation Rule concerning Preservation of Consumer Claims and Defenses ("Holder Rule"), 16 C.F.R. Part 433.

After considering your question about the applicability of the Holder Rule to loans for vocational education, I have reached the conclusion that such loans are typically not subject to the Holder Rule. The Holder Rule is limited in its application to credit transactions as defined in the Truth in Lending Act and Regulation Z. Regulation Z exempts from its coverage many student loan programs. 15 U.S.C. § 266.2 (f). Whether the student loan program with which your client is connected is subject to this exemption, however, is not fully determinable from the facts you have provided.

If you have additional questions on this matter, please do not hesitate to contact me.

Sincerely,
Richard C. Sauer, Attorney
Division of Credit Practices

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

April 12, 1990

Joseph Esposito, Esquire
Akin, Gump, Strauss, Hauer & Feld
1333 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Esposito:

In order to expedite our reply to your recent inquiry concerning the "Holder Rule," Mr. Keller referred your letter to me.

You ask about the applicability of the "Holder Rule," 16 C.F.R. Part 433, to loans for vocational education. As Mr. Sauer indicated in his letter of January 9, the Rule applies only to credit transactions as defined in the Truth in Lending Act and Regulation Z. Regulation Z exempts from its coverage student loans for vocational education *including* those provided under the Guaranteed Student Loan Program, Part B of Title IV of the 1965 Higher Education Act. Therefore, it is the Commission staff's opinion that such loans would not be covered by the Holder Rule.

Please be advised that this is merely the opinion of the Commission staff and is not binding on the Commission. However, it does represent staff's current enforcement position.

Sincerely,
John F. LeFevre
Program Advisor, General Credit Division of Credit Practices

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

June 20, 1990

Joseph Esposito, Esquire
Akin, Gump, Strauss, Hauer & Feld
1333 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Esposito:

This is in reference to my letter to you of April 12, 1990, and Mr. Sauer's letter to you of January 9, 1989, concerning the applicability of the Holder Rule to loans for vocational education. In those letters, we indicated that the Holder Rule would not apply to such loans because Regulation Z of the Truth in Lending Act (TILA) exempts such loans from its coverage, including loans authorized under the Guaranteed Student Loan Program, Part B of Title IV of the 1965 Higher Education Act.

In attempting to provide you with an expedited opinion on this issue, I relied heavily on the underlying premise of Mr. Sauer's letter, namely, that the Holder Rule should be limited in its application to credit transactions that are currently covered by the Truth in Lending Act and Regulation Z. Since I now have reason to believe that this premise may be incorrect, I must retract my letter to you of April 12 until Commission staff has had a chance to thoroughly research the issue.

My doubt stems from the realization that Mr. Sauer's premise was apparently based on several statements in the Commission's Statement of Basis and Purpose (SBP) for the

Rule (approved in 1975) indicating that Holder Rule coverage should be linked to TILA coverage. At that time, however, guaranteed student loans were covered by the TILA; in fact they were not exempted until 1982. This, coupled with the Commission's statement on page 53524 of the SBP (16 CFR 433) that the "[t]he rule expressly applies to credit contracts arising from sales or services, such as trade or vocational school agreements....," appears to indicate that the Commission at that time may have intended the loans at issue to be covered by the Holder Rule.

In any event, it is clear to me that further study is needed before a definitive opinion can be rendered. If we conclude that such loans are covered, it is my intention to recommend that the Commission issue an advisory opinion to that effect. In the meantime I would suggest that your client include the Holder notice in its loan agreements until the Commission acts.

I appreciate your cooperation in this matter and hope that this has not caused inconvenience to you or your client.

Sincerely,
John F. LeFevre
Program Advisor General Credit
Division of Credit Practices

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

July 24, 1991

Jonathan Sheldon, Esquire
National Consumer Law Center
11 Beacon Street - #821
Boston, Massachusetts 02108

Re: Application of Holder Rule to Federally Guaranteed Student Loans

Dear Mr. Sheldon:

This letter responds to your request, made in a filing in connection with the review by the Federal Trade Commission ("Commission") of its Trade Regulation Rule concerning Preservation of Consumers' Claims and Defenses (16 C.F.R. Part 433, the "Rule" or "Holder Rule") pursuant to the Regulatory Flexibility Act. You request a staff opinion letter clarifying the Rule's application to federally guaranteed student loans. For the reasons stated herein, it is the opinion of the FTC staff that federally guaranteed student loans are not exempt from the Rule.

1. *The Commission included educational loans when it promulgated the Rule in 1975.*

The literal scope of the Rule shows no hint of any exception for contracts entered for educational purposes. Under its provisions, a specific clause preserving consumer defenses is to be included in any "consumer credit contract" or "purchase money loan contract" by the seller "(i)n connection

with *any sale* or lease *of* goods or *services to consumers*" within the coverage of the FTC Act. 16 C.F.R. § 433.2 (emphasis added).[1]

The Statement of Basis and Purpose ("SBP") that the Commission issued when it promulgated the Rule, combined with the broad scope of the Rule, leaves no doubt that the Commission intended the Rule to cover for-profit[2] educational loans. 40 Fed. Reg. 53506 (November 18, 1975). In the SBP, immediately after quoting the required contractual language, the Commission stated:

> "The rule expressly applies to credit contracts arising from sales of services, *such as trade or vocational school agreements*..."(emphasis added) *Id.* at 53524.

Similarly, the Commission stated unequivocally that the record in the rulemaking proceeding pursuant to which the Rule was issued was replete with cases of instructional courses where fraud and deception had occurred:

> *"Courses of training or instructions*
>
> ...
>
> (C)ases brought to our attention include courses of

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[1] As you know, if the particular consumer was not referred to the lender, and the lender was not affiliated with or otherwise had no business arrangement with the school, the transaction was not covered by the Rule. 15 C.F.R.. § 433.l(d).

[2] Of course, not-for-profit schools would not be covered, because they are beyond the regulatory authority of the Commission under the Federal Trade Commission Act. 15 U.S.C. § 44.

English language instruction, television and modeling school courses, computer schools, flying lessons, a karate school, and other miscellaneous courses of training or instructions." *Id.* at 53510.

Finally, the federal government's Office of Education had no doubt that the Holder Rule applied, stating in a release issued shortly after the Rule became effective that "all for-profit educational institutions fall within the Rule's definition of 'seller' and are covered" by its provisions and therefore "the school is forbidden to accept the proceeds of the loan unless the lender has included the required notice in the contract."[3]

2. *Congress did not exclude educational loans from coverage under the Rule when it amended the Truth in Lending Act in 1982.*

The only argument that educational loans are not covered focuses on a sequence of events that in no way relates to the substance of the Holder Rule. First, in 1975 when it formulated the key definitions of "purchase money loan" and "financing a sale" and promulgated the Rule, the Commission made reference to the Truth in Lending Act ("TILA") and its implementing Regulation Z.[4] Second, in 1982 Congress

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[3] Bulletin #L16/S9 dated June 28, 1976, directed "TO ALL LENDERS AND EDUCATIONAL INSTITUTIONS" by the Office of Education (Department of Health, Education and Welfare), predecessor to the Department of Education.

[4] [16 CFR §433.l(d-e)]. The former involves a "Finance Charge within the meaning of the TILA. . ." and the latter amounts to a "credit sale within the meaning of the TILA." The definition of "consumer credit contract" [16 CFR §433.1(i)],

amended the TILA to exclude federally guaranteed student loans from that law's coverage in order to avoid imposing on lenders duplicate disclosures that were required on federally guaranteed loans under the Higher Education Act of 1965.[5]

Although a literal interpretation might lead to the conclusion that federally guaranteed student loans became exempt from the Rule as a result of these actions,[6] the

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the document which of course must include the required clause to preserve consumer defenses, incorporates by reference the "purchase money loan" and "financing a sale" definitions.

[5] TILA §104(5), 16 U.S.C. §1603(6), added by Section 701(a) of the Garn-St. Germain Depository Institutions Act of 1982.

[6] The Commission's staff guidelines issued in 1976 assumed that the Rule's adoption of TILA definitions meant that the Commission intended the scope of the Rule to equal that of the TILA. 41 Fed. Reg. 20022 (May 4, 1976). Your submission makes an argument that defining "purchase money loan" to be a cash advance that includes a "finance charge within the meaning of the TILA" means only that a loan is covered if it provides a finance charge that meets the criteria set forth in the statute and regulation [TILA §106, Reg. Z §226.4], and that the Guidelines were therefore wrong to equate the scope of the Rule with the TILA, even as it existed in 1976. Because we base our analysis on the Rule and principles of statutory construction, the Guidelines are not germane to our conclusion. In any event, it is clear that the Guidelines (like the Rule) contemplated the scope of the TILA as it existed in 1975 (or perhaps 1976, in the case of the Guidelines).

universally accepted rule of statutory interpretation that is applicable to this situation demonstrates that the 1982 amendment to the TILA had no impact on the Rule's scope.

The general rule for interpreting a statute that incorporates another statute is that the statute incorporated is taken as it existed at the time of incorporation, without subsequent amendments, unless the legislature has expressly or by strong implication shown its intention to incorporate subsequent amendments. Sutherland, Statutory Construction §51.08 (4th Ed. 1984); *Curtis Ambulance of Florida, Inc. v. Board of County Comm'rs, Shawnee County*, 811 F.2d 1371, 1378-79 (10th Cir. 1987). Stated more generally, if Statute A incorporates Statute B, a subsequent amendment to Statute B is disregarded in construing Statute A unless the legislature clearly intended to affect Statute A as well.[7] A similar interpretation should apply to regulations that incorporate statutes.

Furthermore, the Commission made it clear when the Guidelines were released that they did not change the Rule, stating, "The Commission wishes to call attention to the fact that (the Guidelines) have not been formally reviewed or adopted by the Commission, *nor does anything therein alter or amend either the Rule or the official Statement of Basis and Purpose published with the Rule."* (emphasis added) 41 Fed. Reg. 20022 (May 4, 1976).

[7] This same approach, of course, means that the 1976 Staff Guidelines, insofar as they indicate that the scope of the TILA is the same as the Rule, should be interpreted by using the TILA *as it existed when the Rule was promulgated* (or, with the same result, shortly afterward when the Guidelines were issued) as the frame of reference.

Applying the principle, it is clear to us that the Holder Rule's reference to the TILA and Regulation Z incorporated those laws only as they existed in 1975. In this case, there is no indication that the Commission intended to incorporate changes in the TILA, or that one of Congress' purposes in enacting the 1982 amendment to the TILA was to remove student loans from coverage by the Holder Rule. On the contrary, the purpose of the 1982 amendments was simply to provide students with one set of uniform, clear disclosures for student loans. In sum, the principles of statutory construction require that we disregard amendments to the TILA and Regulation Z made subsequent to the Rule's issuance in 1975, in construing references to them in the Holder Rule.

We are aware that one federal appellate court has held that "loans made, issued or guaranteed under the (Higher Education Act of 1965) have been exempted from the FTC rule on preservation of consumer defenses." *Veal v. First American Savings Bank*, 914 F. 2d 909, 914 (7th Cir. 1990) The quoted material, which was included in an opinion that dealt with a broad range of alleged wrongdoing and legal issues,[8] was set forth without any discussion whatsoever.[9] We respectfully

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[8] The case involved charges of breach of contract, breach of fiduciary duty, fraud, negligence, and violation of the Indiana Deceptive Practices Act and the Higher Education Act of 1965. *Id.* at 912. The opinion also discussed the Indiana UCC and numerous rules issued by the Department of Education. *Id.* at 913-14.

[9] The quoted statement was followed only by two citations. First, it cited 15 U.S.C. §1603(6), the TILA exemption that was added in 1982. Second, it cited 16 C.F.R. §226.3(f), a nonexistent regulation.

disagree, based on the foregoing detailed analysis that (1) the Commission covered student loans when it issued the Rule in 1975 and (2) Congress did not reduce the Rule's scope when it amended the TILA in 1982.

This letter constitutes informal staff opinion that is not binding on the Commission.

Sincerely,
Jean Noonan, Associate Director
for Credit Practices

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

February 11, 1993

Jonathan Sheldon, Esquire
National Consumer Law Center
11 Beacon Street - #821
Boston, Massachusetts 02108

Dear Mr. Sheldon:

This responds to your recent inquiries to my staff concerning the documentation of federally guaranteed student loans in accord with the Commission's Trade Regulation Rule concerning Preservation of Consumers' Claims and Defenses ("Holder Rule" or "Rule"). It is our opinion that all documents evidencing student loan transactions (which you advise are usually promissory notes to the lender) that are covered by the Holder Rule must be drafted to comply with its terms, specifically to include the provision (sometimes called the "Holder notice") that it mandates.

The essence of the Holder Rule is the requirement that any seller of goods or services must include the required clause in the documents evidencing the obligation (16 C.F.R. § 433.2) to provide that if the consumer has a good defense against paying the seller, he or she can defend a claim by the lender on the same basis. There is simply no other way for a provider of goods or services to comply with the Rule than to include this provision in each such document.

It continues to be the Commission staff's opinion that federally guaranteed student loans are not exempt from the

Rule, for the reasons set forth in detail by my predecessor, Jean Noonan, in a letter to you dated July 24, 1991. Those views were subsequently ratified by the Commission in a notice terminating its review of the Holder Rule under the Regulatory Flexibility Act on July 29, 1992 (57 FR 28814, 28815 n.ll). Furthermore, the reasoning in the July 1991 letter was followed by Judge Richey in *Jackson v. Culinary School of Washington*, 788 F. Supp. 1233, 1250-51 (D.D.C. 1992), the only significant judicial opinion we know of that contains legal analysis of this issue.

Where the Rule applies to an educational loan, therefore, the school must include the required clause (Holder notice) in the loan documents. As you are aware, the Rule is inapplicable to not-for-profit schools, which are beyond the regulatory jurisdiction of the Commission under the Federal Trade Commission Act. 15 U.S.C. § 44. Also, if the consumer is not referred to the lender, and the lender is not affiliated with or otherwise has no business arrangement with the school, the Holder Rule will not apply by its own terms. 16 C.F.R. § 433.1(d). In all other cases, the Rule will be in force and require the loan document form to include the necessary provision.

Finally, you inquired about the permissibility of a standard form promissory note that would include the clause required by the Holder Rule, but would allow the lender or seller to strike it out where it was not applicable. We see no reason why this would in any way contravene the Holder Rule.

This letter constitutes an informal staff opinion that is not binding on the Commission.

Yours truly,
David Medine
Associate Director for Credit Practices